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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner*,

v.

ASHBY OLIVER STEWART, *Respondent*.

BRIEF FOR RESPONDENT.

W. GLENN HARMON,
ERNEST L. WILKINSON,
JOHN W. CRAGUN,
J. EDWARD JOHNSON,
Counsel for Respondent.

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INDEX

	Page
Opinions Below	1
Jurisdiction	1
Questions Presented	2
Statutes Involved	2
Statement of Facts	3
Summary of Argument	5
Argument	7
I. The question is the construction of an express statute and not of an implied exemption	7
A. The function of the Court is to ascertain and enforce the will of Congress	7
B. *Willcuts* v. *Bunn* is inapplicable	8
II. Congress, by enacting Section 26, intended to exempt from taxation all income, including capital gain, having its source in the bonds	11
A. Petitioner's attack upon decision below	11
B. Common understanding of the words "income derived therefrom"	11
C. Internal construction of the Farm Loan Act	16
D. Comparison of Section 26 with other exemption statutes	18
E. Congress had sound reason to exempt capital gains from farm loan bonds from taxation	20
F. Legislative history of Section 26	23
G. Administrative construction of the words "income derived therefrom"	28
H. Legislative construction of Section 26	34
I. Section 26 has not been repealed, amended or interpreted by the Revenue Acts until 1938	40
III. Neither the rule of strict construction nor the argument based on the exemption from state taxation can prevail	44
A. The doctrine of strict construction cannot defeat the exemption	44
B. The argument based on exemption from state taxation is fallacious	47
C. The cases alleged to be analogous are clearly distinguishable	50
IV. Petitioner is estopped to assert the tax	52
V. Conclusion	54

TABLE OF CASES CITED.

Page

Agricultural Securities Corp. v. Commissioner, 39 B. T. A. 1103....23, 30, 50
Alexander v. Mayor, etc., 5 Cranch, 1.... 39
Atwater & Co., William C., v. United States (S. D. N. Y., 1936), 18 F. Supp. 564.... 54
Bank v. Sherman, 101 U. S. 403.... 7
Barber Asphalt v. Denver (8 C. C. A. 1896), 72 Fed. 336.... 39
Black v. Bolen (1920, W. D. Okla.), 268 Fed. 427, writ of error dismissed per cur. (C. C. A. 8, 1921), 277 Fed. 1013.... 53
Blackbird v. Commissioner Int. Rev. (C. C. A. 10th, 1930), 38 F. 2d 976.. 41
Bowers v. West Virginia Pulp & Paper Co., 297 Fed. 225, cert. den., 265 U. S. 584.... 31
Branson v. Wirth, 17 Wall. 32.... 54
Brewster v. Gage, 280 U. S. 327.... 31
Brushaber v. Union Pac. R. Co., 240 U. S. 1....7, 13
Caha v. United States, 152 U. S. 211.... 44
Central Hanover Bank & Trust Co. v. United States (C. Cls), 14 F. Supp. 541, cert. den. 300 U. S. 678.... 51
Charlotte Harbor & N. R. Co v. Welles, 260 U. S. 8.... 34
Citizens Bank v. Parker, 192 U. S. 73....10, 45, 46
Clark v. Bever, 139 U. S. 96.... 7
Cooke v. United States, 91 U. S. 389.... 54
Cope v. Cope, 137 U. S. 682.... 39
Denver & R. G. R. Co. v. United States (1918), 53 C. Cls. 155.... 54
Deputy v. duPont, 308 U. S. 488.... 18
Des Moines Opinion (Ex. 6, R. 85)....17, 29, 31, 32, 33
DeStuers v. Commr., 26 B. T. A. 201.... 51
Dewey v. United States, 178 U. S. 510.... 7
Dick v. Commissioner (C. C. A. 10th, 1935), 76 F. 2d 265, cert. den. 296 U. S. 588.... 41
Doyle v. Mitchell Bros. Co., 247 U. S. 179....13, 14
Duval, Rec'r. v. United States (1889), 25 C. Cls. 46.... 54
Eager v. United States (1898), 33 C. Cls. 336.... 54
Edwards v. Wabash Ry. Co., 264 Fed. 610.... 31
Joseph Eichelberger & Co. v. Comm'r Int. Rev. (5th C. C. A. 1937), 88 F. 2d 874.... 54
Eisner v. Macomber, 252 U. S. 189.... 13
Electric Storage Battery Co. v. Shimadzu, 307 U. S. 5.... 33
Ex parte Crow Dog, 109 U. S. 556.... 40
Farmers', etc. National Bank v. Dearing, 91 U. S. 29.... 39
Federal Land Bank v. Crosland, 261 U. S. 374....47, 50, 52
Federal Trade Commission v. Raladam Co., 283 U. S. 643.... 26
First Natl. Bank v. Missouri, 263 U. S. 640.... 39
French v. Spencer, 21 How. 228.... 7
Frost v. Wenie, 157 U. S. 46.... 40
Gibbons v. District of Columbia, 116 U. S. 404.... 7
Glynn v. United States (1897), 32 C. Cls. 100.... 53
Gould v. Gould, 245 U. S. 151.... 44
Graham v. Goodcell, 282 U. S. 409.... 40
Graves v. People of New York, 306 U. S. 466.... 50
Greiner v. Lewellyn, 258 U. S. 384.... 51
Grosfield v. First National Bank, 73 Mont. 219, 236 Pac. 250.... 44
Hale v. State Board, 302 U. S. 95....9, 51
Hamersley v. United States (C. Cls.), 16 F. Supp. 768.... 51
Hamilton v. Dillin, 21 Wall. 73.... 34
Hamilton v. Rathbone, 175 U. S. 414.... 46
Hartley v. Commissioner, 295 U. S. 216.... 39
Hartson v. United States, 21 C. Cls. 451.... 54
Hassett v. Welch, 303 U. S. 303.... 37

Page

Hayes v. Gauley Mt. Coal Company, 247 U. S. 189 13
Hecht v. Malley, 265 U. S. 144 24
Heinz v. Commr. (3d C. C. A. 1939), 101 F. 2d 453 47
Helvering v. Bliss, 293 U. S. 144 47
Helvering v. Gerhardt, 304 U. S. 405 ..... 50, 53
Helvering v. Gowran, 302 U. S. 238 34
Helvering v. New York Trust Co., 292 U. S. 455 39
Helvering v. R. J. Reynolds Tobacco Co., 306 U. S. 110 31
Helvering v. Stockholms Enskilda Bank, 293 U. S. 84 ..... 44, 45
Helvering v. Twin Bell Oil Syndicate, 293 U. S. 312 39
Helvering v. Winmill, 305 U. S. 79 32
Helvering v. Wood, 309 U. S. 344 20
Higgins v. Smith, 308 U. S. 473 39
Hitner v. Lederer (C. C. A. 3d), 63 F. 2d 877 51
Homeratha v. United States (W. D. Okla., 1930), 40 F. 2d 305, app. dis. (C. C. A. 10th, 1931), 49 F. 2d 1086 41
Humphrey's Executor v. United States, 295 U. S. 602 27
Igleheart v. Commr. (C. C. A. 5th), 77 F. 2d. 704 51
James v. Commr., 13 B. T. A. 764 (C. C. A. 2nd), 49 F. 2d 707 51
Jordan v. Roche, 228 U. S. 436 39
Knight, Adm'r. v. United States (1900), 35 C. Cls. 129 54
Kohlsaat v. Murphy, 96 U. S. 153 ..... 45, 46
Krauthoff v. Kansas City Joint Stock Land Bank (8th C. C. A. 1929), 31 F. 2d 75 47
Lake County v. Rollins, 130 U. S. 662 7
Levy's Lessee v. McCartee, 6 Pet. 102 16
License Tax Cases, 5 Wall. 462 39
Lincoln Chemical Co. v. Edwards, 289 Fed. 458 31
Lindsey v. Hawes, 2 Black 554 54
Lyeth v. Hoey, 305 U. S. 188 7
Lynch v. Alworth-Stephens Co., 267 U. S. 364 18
MacLaughlin v. Alliance Insurance Co., 286 U. S. 244 ..... 8, 15
McCulloch v. Maryland, 4 Wheat. 316 50
McFeely v. Commr., 296 U. S. 102 47
McGuire v. Commr., 32 B. T. A. 1075 51
McNeil v. McNeil, 61 Utah 141, 211 Pac. 988 44
Manhattan Properties v. Irving Trust Co., 291 U. S. 320 33
Silas Mason Co. v. Tax Commissioner, 302 U. S. 186 33
Matthews v. McStea, 91 U. S. 7 39
Mattingly v. District of Columbia, 97 U. S. 687 34
Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509 ..... 13, 14
Mid-Northern Oil Co. v. Walker, 268 U. S. 45 38
Morf v. Bingaman, 298 U. S. 407 40
Movius v. Arthur, 95 U. S. 144 40
Murdock v. Ward, 178 U. S. 139 51
Mutual Life Ins. Co. v. Phinney, 178 U. S. 327 53
National Lead Co. v. United States, 252 U. S. 140 33
New York, P. & N. R. Co. v. Pennsylvania Exchange, 240 U. S. 34 39
Old Colony Railroad Co. v. Commissioner, 284 U. S. 552 16
Old Mission Portland Cement Co. v. Helvering, 293 U. S. 289 33
Osborn v. The Bank, 9 Wheat. 738 46
Owensboro Natl. Bank v. Owensboro, 173 U. S. 664 49
Ozawa v. United States, 260 U. S. 178 7
Phipps v. Commr. (C. C. A. 10th), 91 F. 2d 627, cert. den. 302 U. S. 742 .. 51
Pitman v. Commissioner (C. C. A. 10th, 1933), 64 F. 2d 740 41
Pittman v. H. O. L. C., 308 U. S. 21 ..... 7, 45, 46, 47, 52
Plummer v. Coler, 178 U. S. 115 51
Pompton v. Cooper Union, 101 U. S. 196 39

	Page
Posadas v. National City Bank, 296 U. S. 497	40
Rafferty v. Smith, Bell & Co., 257 U. S. 226	34
Red Rock v. Henry, 106 U. S. 596	40
Ritter v. United States (3d C. C. A., 1928), 28 F. 2d 265	54
Roche's Beach, Inc. v. Commr. (2d C. C. A. 1938), 96 F. 2d 776	47
Rodgers v. United States, 185 U. S. 83	40
Roebling v. Commr., 37 B. T. A. 82	51
Sarlls v. United States, 152 U. S. 570	39
Schuyler Co. v. Thomas, 98 U. S. 169	10
Sessions v. Romadka, 145 U. S. 29	24, 33
Smith v. Kansas City Title & Trust Co., 255 U. S. 180	7, 47, 49, 50
Spencer v. United States (8 C. C. A. 1909), 169 Fed. 562	39
Stanton v. Baltic Mining Co., 240 U. S. 103	7
State v. Stoll, 17 Wall. 425	40
State of Utah v. United States, 284 U. S. 534	52
Staten Island, etc., Co. v. United States (C. C. A. 2d, 1936), 85 F. 2d 68	53
Stern Bros. v. Commissioner Int. Rev. (C. C. A. 8th, 1940), 108 F. 2d 309	2, 11, 18
Stratton's Independence v. Howbert, 231 U. S. 399	13, 14
Sturm v. Boker, 150 U. S. 312	53
Swayne & Hoyt v. U. S., 300 U. S. 297	34
Swigart v. Baker, 229 U. S. 187	39
Taft v. Bowers, 278 U. S. 470	15
Tax Commissioner v. Putnam, 227 Mass. 522	12
Tinco v. Forbes, 228 U. S. 549	34
Tiger v. Western Investment Co., 221 U. S. 286	39
Trinidad v. Sagrada Orden de Predicadores, 263 U. S. 578	47
Union & New Haven Tr. Co. v. Eaton (D. C. Conn. 1927), 20 F. 2d 419	47
United States v. Bank of Metropolis, 15 Pet. 377	54
United States v. Dakota-Montana Oil Company, 288 U. S. 259	32, 33
U. S. v. Freeman, 3 How. 556	38, 45
United States v. Gillis, 95 U. S. 407	40
United States v. Goldenberg, 168 U. S. 94	7
United States v. Great No. Ry. Co. (8th C. C. A. 1932), 57 F. 2d 385, aff'd 287 U. S. 144	54
United States v. Heinszen & Co., 206 U. S. 370	34
United States v. Merriam, 263 U. S. 179	16
United States v. Nix, 189 U. S. 199	40
United States v. Pleasants, 305 U. S. 357	47
United States v. Shreveport Gr. & El. Co., 287 U. S. 77	46
United States v. Stafoff, 260 U. S. 477	41
United States v. Temple, 105 U. S. 97	7
U. S. Trust Co. v. Helvering, 307 U. S. 57	51
Utah v. United States, 284 U. S. 534	52
Utah P. & L. Co. v. United States, 243 U. S. 389	52
Van Allen v. The Assessors, 3 Wall. 573	48
Washington v. Miller, 235 U. S. 422	40
West Co. v. Johnson, 66 P. 2d 1211, cert. den. 302 U. S. 638	52
M. G. West Co. v. Johnson, 66 P. 2d 1211, cert. den. 302 U. S. 638	7
White v. United States (1938), 86 C. Cls. 728, 22 F. Supp. 821	47
White v. United States, 191 U. S. 545	7
White v. United States, 305 U. S. 281	45
Wilber Nat. Bank v. United States, 294 U. S. 120	52
Willcuts v. Bunn, 282 U. S. 216	5, 8, 9, 12, 23, 31, 47, 49, 50
Wilson v. Commr., 31 B. T. A. 1022	51
Wilson v. Shaw, 204 U. S. 24	34
Woodworth v. Kales (6th C. C. A., 1928), 26 F. 2d 178	54
Y. M. C. A. Retirement Fund, Inc. v. Commr. (1929), 18 B. T. A. 139	47

TREATISES AND MISCELLANEOUS AUTHORITIES

Page

Department of Justice, Taxation of Government Bondholders and Employees—the Immunity Rule and the Sixteenth Amendment, Government Printing Office, 198 15
I. T. 2779, XIII-1 CB 41
I. T. 2655, XI-2 CB 41
I. T. 3069, CB 1937-1 41
I. T. 1806, CB II-2 28
Regulations 33, Art. 150 13
Regulations 45, Art. 544 13
Regulations 45, Art. 71 41
Regulations 45, Art. 76 41
Regulations 62, Art. 76 41
Regulations 74, Art. 81 41
Regulations 74, Art. 85-90 41
Regulations 74, Art. 86 41
Regulations 77, Art. 85-90 41
Regulations 77, Art. 51 14
Regulations 77, Art. 86 41
Regulations 101, Art. 22 13
Opinion of General Counsel, Des Moines Joint Stock Land Bank, Ex. 6, R. 85 ..... 17, 29, 31, 32, 33
34 Opp. Atty. Gen. 439, Treas. Decision 3754, IV-2 CB p. 37 41
34 Opp. Atty. Gen. 275, Treas. Decision 3570, III-1 CB p. 85 41
35 Opp. Atty. Gen. 107 41
Paul and Mertens, Law of Federal Income Taxation 44
Yale Law Journal, Vol. 49, p. 352 9

STATUTES, ETC.

Constitution of the United States, 16th Amendment 14, 20
Judicial Code, Sec. 240(a) 2
Federal Farm Loan Act, July 17, 1916, c. 245, 39 Stat. 360, 12 U. S. C.
Generally 27, 32, 35, 42, 47
Sec. 3 ..... 28, 42, 52
Sec. 12 21
Sec. 13 16
Sec. 16 ..... 16, 21
Sec. 21 42
Sec. 22 16
Sec. 26 ..... 2, 4, 5, 6, 7, 10, 11, 16, 27, 28, 32, 34, 37, 38, 39 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 52
Federal Reserve Act, December 23, 1913, c. 6, 38 Stat. 251, 12 U. S. C. §531 ..... 5, 14, 19, 24
Act of July 14, 1870, c. 256, 16 Stat. 272 18
Intermediate Credit Bank, Act of March 4, 1923, c. 252, 42 Stat. 1454 19, 27, 35, 42
Act of May 12, 1933, c. 25, 48 Stat. 46, § 810 ..... 27, 30
Federal Farm Mortgage Corp., Act of January 31, 1934, 48 Stat. 344, as amended, c. 33, 48 Stat. 360, 12 U. S. C. § 1020f 19, 27, 35, 42
Commodity Credit Corp. Act of March 8, 1938, c. 44, 52 Stat. 107 ..... 20, 28
Revenue Act of 1916, c. 463, 39 Stat. 756 43
Sec. 4 41
Sec. 22 40
Revenue Act of 1928, c. 852, 45 Stat. 797:
Sec. 11 51
Sec. 606 29
Revenue Act of 1938, c. 289, 52 Stat. 447, 578, § 817, 12 U. S. C. § 931(a) 3, 6, 27, 34, 37, 36, 39, 43

CONGRESSIONAL REPORTS, ETC.

Congressional Record: Page

Vol. 53 ..... 22, 26, 48
Vol. 83 37
Report of U. S. Commission, Sen. Doc. No. 380, 63d Cong., 2d Sess. 21, 22, 24, 25
Sen. Rep. No. 144, 64th Cong., 1st Sess., Senate Committee on Banking and Currency on Rural Credit 21, 26
Sen. Report 317, 66th Cong., 1st Sess., Committee on Banking and Currency 32
Hearings, Senate, on H. R. 12863, part 2, 65th Cong., 2d Sess. 29
Hearings, Senate Committee on Finance, 75th Cong., 3d Sess. on H. R. 9682 ..... 27, 33, 35
Hearings, Senate Committee on Banking and Currency, 1913-1915, Vol. 35. 25
Joint Hearings before sub-committee of Committee on Banking and Currency of the Senate and House on Rural Credit, 63d Cong., 2d Sess., 1914 ..... 23, 24, 25, 26
S. 289, 64th Cong., 1st Sess. 26
S. 319, 66th Cong., 1st Sess. 32
S. 4061, 63d Cong., 2d Sess. 26
H. R. Doc. 679, 63d Cong., 2d Sess. 21, 22, 24
H. R. Rep. No. 69, Committee on Banking and Currency on Federal Reserve Banks, 63d Cong., 1st Sess. 24
H. R. Rep. No. 630, 64th Cong., 1st Sess., House Committee on Banking and Currency 21
H. R. 630, 64th Cong., 1st Sess. 26
H. R. 15004, 64th Cong., 1st Sess. 26

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 13.

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

ASHBY OLIVER STEWART, *Respondent.*

BRIEF FOR RESPONDENT.

OPINIONS BELOW.

The opinion of the District Court (R. 36-43) is reported (although without the additional findings appearing at R. 41-3) in 24 F. Supp. 145. The opinion of the Circuit Court of Appeals (R. 128-135) is reported in 106 F. 2d 405.

JURISDICTION.

The judgment below was entered August 30, 1939. (R. 135.) Time within which the petition might be filed was extended by Mr. Justice Reed for a period of sixty days from November 30, 1939. (R. 136.) The petition was filed on January 26, 1940. Petitioner invoked the jurisdiction

of this Court under § 240(a) of the Judicial Code, upon a conflict of the decision below with a decision in the Eighth Circuit Court of Appeals,[1] and upon a claim of general importance of the question involved. This Court granted the writ of certiorari on March 25, 1940. (R. 137.)

QUESTIONS PRESENTED.

1. Whether income derived from Federal farm loan bonds through the surrender of those bonds to the receiver of the issuing bank for an amount in excess of the amount paid for them, is exempt from income tax by reason of Section 26 of the Farm Loan Act of July 17, 1916 (Title 12 U. S. C. §931) exempting from tax the bonds "and the income derived therefrom".

2. Whether income derived from Federal farm loan bonds through the sale of such bonds on the market for an amount in excess of the amount paid for them, is exempt from income tax by reason of the same section.

3. Whether petitioner is estopped to assert taxability of the income involved, by reason of the representations of an agency of petitioner authorized to make such representations, on which respondent relied.

STATUTES INVOLVED.

Section 26 of the Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat. 360, 380, § 26, 12 U. S. C. § 931, provides in part:

> "That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen

[1] *Stern Bros.* v. *Commissioner Int. Rev.* (C. C. A. 8th, 1940), 108 F. 2d 309.

of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such *they and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation." (Italics added.)

The Revenue Act of 1938, c. 289, 52 Stat. 447, 578, 12 U. S. C. § 931(a), provides:

> "Sec. 817. *Income from Obligations and Mortgages Issued by Joint-Stock Land Banks.* Notwithstanding the provisions of section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this Act, *all income, except interest, derived therefrom* shall be included in gross income and shall not be exempt from Federal income taxation." (Italics added.)

Other related statutes will be found in the Appendix, pp. 1-19.

STATEMENT OF FACTS.

Respondent brought this action in the United States District Court for the Northern District of California, Southern Division, to recover $4,107.76 for an overpayment of taxes made under protest for the taxable year 1931. (R. 2-12) The facts found concurrently below may be summarized as follows:

Respondent, for himself and wife,[2] during 1930, purchased at below par farm loan bonds issued under the Federal Farm Loan Act of 1916 by the Kansas City Joint Stock Land Bank, and in the following year, 1931, surrendered said bonds to the receiver in liquidation of the issuing bank for an amount below par but in excess of what

[2] Respondent's wife is appellant in case No. 9101 below, which was consolidated with this case for trial, and will be controlled by the final decision herein.

he paid by $76,360.95. (R. 30, 31, 36-40.) Respondent also, during 1930, purchased at below par bonds issued under the same act by the Bankers' Joint Stock Land Bank of Milwaukee, which in 1931 he sold for an amount below par but in excess of what he had paid therefore by $7,915. (R. 30, 31, 36-40.) The total gains derived from the bonds in the two transactions were $84,275.95. (R. 31-32.) Both issuing banks were in receivership when the bonds were purchased; no interest was being paid by either; and the purchases were made for the prospective increment and not for their interest. (R. 41-42.)

From the time of the passage of the Farm Loan Act in 1916, the Federal Farm Loan Board issued various circulars and bulletins to acquaint the public with the Act and with the advantages of Federal farm loan bonds, which contained statements that the bonds and their income were "free from all forms of taxation," including "income tax and all forms of State and municipal tax of every kind and character," etc. Respondent saw and studied these and other circulars, none of which negatived or restricted the language above quoted. (R. 37, 42-3.) He relied upon these statements in making his purchases, reasonably believing he was purchasing securities the income from which, in case of sale, would be exempt income. (R. 42-3.)

The District Court held that the income involved was not exempt from tax. (R. 35-43, 24 F. Supp. 145.) The Circuit Court of Appeals reversed, (R. 128-135, 106 F. 2d 405), holding that Section 26, exempting income derived from the bonds from all taxes, was as broad as the income-tax statute under which the tax had been assessed.

SUMMARY OF ARGUMENT.

I. The primary question is whether Congress by Section 26 of the Farm Loan Act intended to exempt from the income tax capital gains on farm loan bonds. Petitioner should not ask the Court to legislate on this matter, nor to do more than ascertain and give effect to the will of Congress in granting the exemption. The rules as to implied constitutional exemptions, such as were involved in *Willcuts* v. *Bunn*, 282 U. S. 216, have no application where Congress has spoken; for express statutes should be enforced according to the intention of the legislature.

II. If, as petitioner concedes, the word "income" comprehends capital gains, it cannot follow that the phrase "income derived" from farm loan bonds does not include such gains. By the phrase used, Congress pointed out that only such gains (and other income, *i. e.*, interest) as were derived from farm loan bonds, as distinguished from other bonds or investments, should be exempt. That gains on sales of property are in fact derived from the property sold and not from the sale of or dealing in the property (which simply marks the incidence of the tax) has been affirmed by this Court repeatedly. That this concept was incorporated into the Farm Loan Act is shown by (1) the internal construction of the act, its use of the words "income" and "interest," and its recognition that there would be capital gains; (2) a comparison with other exemption statutes, which disclose a discriminating care on the part of Congress to grant exemptions to accord with its policy on the particular subject matter before it; (3) the sound reasons for granting a broader exemption, to give bonds in this new field a competitive advantage over other bonds, and to insure maintenance of the market to effectuate the legislative purpose; (4) the source of the language of the exemption statute—the Federal Reserve Act—where it had originated to give complete exemption from the income tax to Federal reserve banks in all their dealings; (5) the consistent, long-continued administrative construction to the effect that cap-

ital gains are included within the exemption; (6) legislative construction by Congress in § 817, Revenue Act of 1938.

This meaning of Section 26 was not changed by later revenue acts, either through implied repeal or interpretation; for implied repeals are not favored, and there is no evidence that Congress intended either repeal or interpretation. Moreover, consistent administrative construction discloses that Section 26 was never repealed, interpreted or even amended until 1938; that until then it was the sole measure of the exemption granted.

III. The doctrine of strict construction is inapplicable; for just as construing strictly the words levying the tax cannot keep these gains and profits from constituting "income," so construing strictly the words of the exemption clause cannot limit the word "income" so that the phrase means merely "interest derived therefrom." The goal is the intent of Congress. Strict construction is not a substitute for and cannot overbalance other canons such as legislative history, administrative construction and legislative construction.

Petitioner's argument, based on a comparison of the exemption from Federal taxation with the exemption granted from state taxation, is fallacious. Congress has spoken; the question is what it intended, not how far it could go in exempting the bonds from state taxation.

The alleged "analogous cases" relied on by petitioner do not apply; for not one of them involved an exemption statute which was aimed squarely at and designed to defeat the very tax asserted, as here.

IV. Petitioner is estopped to assert the tax. Respondent purchased the bonds for their increment, reasonably believing, in reliance upon representations of the United States, that such capital gains as he might make would be tax-exempt. The agency of petitioner was specifically authorized to make the representations which it did, for the purpose of inducing investors to invest. Petitioner's defense that the representations were of matters of law is beside the point in the circumstances.

ARGUMENT.

I. The Question is the Construction of an Express Statute and Not of an Implied Exemption.

A. The primary question is whether Congress by Section 26 intended to exempt the income here involved. Although this is recognized by petitioner's brief in the implicit admission that Section 26 governs, yet petitioner seeks to apply reasoning and cases quite sterile of help in that direction. Petitioner should realize that "The courts have no function of legislation, and simply seek to ascertain the will of the legislator." *United States* v. *Goldenberg,* 168 U. S. 94, 103; see *Ozawa* v. *United States,* 260 U. S. 178, 194. "It is our business to execute the law as we find it, and not to make or modify it." *Bank* v. *Sherman,* 101 U. S. 403, 406. Congress may grant exemptions in its discretion. *Gibbons* v. *District of Columbia,* 116 U. S. 404, 408; *Brushaber* v. *Union Pac. R. Co.,* 240 U. S. 1; *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103. Accordingly, although there is much current agitation for the elimination of all exemptions, such elimination should come through the regular processes of legislation rather than through judicial legislation; for it is the will of Congress which controls the meaning of taxing statutes and exemptions granted from the tax. *Lyeth* v. *Hoey,* 305 U. S. 188, 194.[3] As to the Farm Loan Act exemption itself, this Court has specifically stated (*Smith* v. *Kansas City Title & Trust Co.,* 255 U. S. 180, 213):

> "With the wisdom and policy of this legislation we have nothing to do. Ours is only the function of ascertaining whether Congress in the creation of the banks, and in exempting these securities from taxation, federal

[3] This elementary doctrine is supported by a mass of additional cases, among which see *Dewey* v. *United States,* 178 U. S. 510, 521; *French* v. *Spencer,* 21 How. 228, 238; *United States* v. *Temple,* 105 U. S. 97, 99; *Clark* v. *Bever,* 139 U. S. 96, 108; *White* v. *United States,* 191 U. S. 545, 551; *Lake County* v. *Rollins,* 130 U. S. 662, 670; *Pittman* v. *H. O. L. C.,* 308 U. S. 21, 32-3; *M. G. West Co.* v. *Johnson,* 66 P. 2d 1211, cert. den. 302 U. S. 638.

> and state, has acted within the limits of its constitutional authority."

B. Petitioner, as did the trial court, has placed its reliance on *Willcuts* v. *Bunn*, 282 U. S. 216,[4] where the taxpayer claimed, by reason of implied constitutional immunity, to be exempt from Federal income tax on capital gains on state bonds. This Court held that such gains were not within the ambit of the implied immunity, saying (p. 231):

> "It must be remembered that we are dealing, not with any express constitutional restriction, *but only with an asserted implication.*" (Italics added.)

That case, as pointed out by the court below (R. 134) was "'without qualification by any special circumstances'," (282 U. S. 224) such as a statute exempting all income derived from the bonds. It involved no consideration of the meaning of the words "income derived therefrom", the very point in dispute in the present case, nor why Congress used the word "income" instead of "interest". It involved no question of the intent of Congress. It cannot, therefore, afford assistance in determining such intent. If that intent was to exempt these gains the *Bunn* case could not change it; conversely, if the intent was not to exempt these gains, the income is taxable for that reason and not because of the *Bunn* case; for whether the tax is leviable or not depends upon the expressed will of Congress and not upon the mere implication of constitutional exemption upon which the *Bunn* case turned.

Nor did the *Bunn* case purport to overrule the long line of decisions hereinafter cited[5] to the effect that capital gains as "income" are derived from capital, a concept reaffirmed in *MacLaughlin* v. *Alliance Insurance Co.*, 286 U. S. 244, a year and a half subsequent to it.

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[4] The trial court recognized that the *Bunn* case was "not broad enough to constitute an adjudication upon the question immediately confronting us." (R. 37.)

[5] See cases, *infra*, pp. 13-15.

Petitioner places special reliance on the language of the *Bunn* case (pp. 227-8), that a tax upon profits made through purchases and sales of bonds is in effect an excise upon the result of a combination of several factors, including capital investment and quite generally some measure of sagacity, so that the gain may be regarded as "the creation of capital, industry and skill."[6] That language could not possibly have been in the minds of the 1916 Congress when it was creating an entirely new system of rural credit and was confronted with hard realities incident to enticing private investors into a new field. Our concern here is confined to learning what Congress meant in 1916. As this Court said in *Hale* v. *State Board*, 302 U. S. 95, 101:

> "Our search is for something more than the meaning of a property tax or an excise in the thought of skilled economists or masters of finance. It is for the meaning that at a particular time and place and in the setting of a particular statute might reasonably have been accepted by men of common understanding."

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[6] The opinion of the court below herein was the subject of a comprehensive note in Volume 49, Yale Law Journal, No. 2, December, 1939, p. 352, entitled "Taxation of Capital Gains on Tax Exempt Federal Securities." In discussing the relation of *Willcuts* v. *Bunn* to the present problem, the author said (p. 356):

"The Supreme Court realistically pointed out that capital gain is the final product of at least three factors, 'the creation of capital, industry, and skill,' leaving no doubt that one factor is the bond itself. A literal application of this view to the exempting statute calls at most for segregation of capital gain into taxable and nontaxable proportions, since the operative clause forbids taxation of that portion derived from the bond. The economic absurdity of such a calculation emphasizes the fallacy of applying general language in a remote case to decisions which must be primarily concerned with the meaning of words in a specific context of time and circumstance. Moreover, the status of capital gains in the *Bunn* case, as of 1931, is relevant only so far as it is some evidence of current significance of the term in question, to be weighed in the balance with indications of contemporary Congressional intent."

And in *Citizens Bank* v. *Parker*, 192 U. S. 73, 80:

> "With the wisdom or folly of the charter we have nothing to do. Our sole function is to interpret it. It may seem, in 1903, to have been imprudent legislation. But how did it appear in 1833 and 1836? *We must contemplate it as of that time.*" (Italics added.)

See also *Schuyler Co.* v. *Thomas*, 98 U. S. 169, 172.

Petitioner ignores the fact that the tax here asserted is levied quite apart from skill and sagacity or the steps involved in producing income, just as the exemption from the tax does not depend thereon. There is as much opportunity for the employment of skill and sagacity and "inside information"[7] by Federal land banks, admittedly exempt under the identical phraseology of the first sentence of Section 26, or joint stock land banks held exempt on gains from farm loan bonds under the second sentence,[8] yet that fact has not deprived either of them of the benefits of the exemption. Moreover, in this very case over 90 per cent of the profits were derived from bonds surrendered to the bank receiver in liquidation. The collection of liquidating dividends requires no skill or sagacity.

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[7] Petitioner intimates (Brief, pp. 9-10) that respondent, while not shown to have been trading on "inside information", was strategically situated more readily to take advantage of information available to the general public, so that the income he derived from the bonds through their sale at a profit was the product not merely of the bonds in which he had invested, but also arose from his skill. The gratuitous suggestion of the use of "inside information" has occurred in this case for the first time in the Government's brief.

[8] Des Moines Opinion, R. 85-93.

II. Congress, by Enacting Section 26, Intended to Exempt from Taxation All Income, Including Capital Gain, Having Its Source in the Bonds.

A. Petitioner seeks to explain syllogistically the decision of the court below, stating that the court thought that since "income" comprehends capital gains, and since Section 26 of the Farm Loan Act exempts "income," it follows that Congress intended to exempt capital gains. Petitioner claims that a fallacy in this argument lies in the fact that the exemption is not merely of "income" but of bonds and the "income derived therefrom". Actually petitioner is completely wrong in contending that the court substituted the word "income" for the phrase "income derived therefrom"; for it gave entire consideration to the interpretation of that phrase and followed the judicial decisions which also considered it (R. 131).[10] Furthermore, if, as now conceded, the word "income" includes capital gains, (Petr.s' Brf., pp. 6, 7, note 3) it is difficult to see how Congress could have more aptly chosen words to exempt such capital gains on farm loan bonds. Apparently, according to petitioner's view, it would be necessary for Congress to exempt the income derived not only from farm loan bonds but from whatever source derived—that is, repeal the income tax on all capital gains—in order to accomplish this result. For if the word "income" includes these gains, then the fact that Congress, to distinguish them from like gains obtained from other bonds (or sources), described them as being derived from farm loan bonds, does not remove them from the scope of such word.

B. By common understanding, profit realized upon the sale or disposal of property is considered to be income

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[10] It is to be noted that the opinion of the Eighth Circuit Court in the related case, *Stern Bros.* v. *Commissioner* (C. C. A. 8th, 1940), 108 F. 2d 309, which afforded the conflict necessary for review of the problem by this Court, contains no critical analysis either of the intent of Congress or of the meaning of the phrase "income derived therefrom". It did little more than to pass the question to this Court.

derived from that property. Petitioner concedes (Brief p. 7) that the gains in question were income. But petitioner would evade the effect of such concession by denying that the income was derived from the *bonds*, and asserting it came from *dealings* in the bonds. Petitioner completely ignores that it is a stipulated fact that every penny paid to respondent by the receiver of the Kansas City bank was paid "under and pursuant to the covenants contained in said bonds" (R. 31). Respondent controlled neither the time when the bonds were surrendered nor the amount received therefor. Obviously all of it flowed directly from said bonds. The same fact is hardly less evident as to bonds sold on the market; without them there could have been no dealing, no sale, no profit; the bonds were the proximate cause, the very essence of the transactions. The Court in *Wilcutts* v. *Bunn* quoted and cited (282 U. S. 218, 228) with approval *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531, as authority for regarding the gain as "'the creation of capital, industry and skill.'" In that case, the Massachusetts court itself said (p. 529): "The transactions could not be carried out except for the use of capital and the profit is *derived directly from the capital* in combination with skill in selecting time for purchase and for sale." This being true, it would seem that petitioner herein has its causal chain reversed: it is the *dealings* which are indirectly involved in production of this income, if anything, rather than bonds, the latter being directly involved. The gains came to respondent because of his ownership of the bonds and his exercise of one of the principal attributes of ownership. How, then, can petitioner seriously contend that (Petr.'s Brf., p. 7) "the bonds were involved only indirectly," and that the income was derived from "*dealings in the bonds* rather than from mere ownership"? Only by showing that such a contention accorded with the understanding of Congress on the subject,—a showing petitioner does not make.

This Court has entertained no such uncertainty as to the phrase "income derived therefrom" including capital gains. Nor has the Government up until now. In 1913, three years before the passage of the Farm Loan Act, in construing the Excise Tax Act of 1909, this Court ruled that "income may be defined as the gain derived from capital, from labor, or from both combined." *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415. In *Brushaber* v. *Union Pac. R. Co.*, 240 U. S. 1, 16, 17, decided 6 months before enactment of the Farm Loan Act the Court again talked of the "source whence the income was derived." The definition in the *Howbert* case was again reaffirmed in *Doyle* v. *Mitchell Bros. Company*, 247 U. S. 179, 185,[12] some 2 years after the Farm Loan Act, under the Revenue Act of 1916.

In *Eisner* v. *Macomber*, (1920) 252 U. S. 189, pp. 206-7, this Court, in searching for "a clear definition of the term

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[12] In the *Doyle* case which concerned an excise tax for doing business based upon net income "received by it [taxpayer] from all sources during such year" (Section 38, Excise Tax Act 1909, 36 Stat. 11) the Court refused to permit the Commissioner to include within the measure of the tax accretions to property from the time of its purchase up to January 1st, 1909, and confined the tax to accretions after that date, although the entire amount was received within taxable period. The Court cited and quoted in its opinion and in footnotes several Treasury regulations recognizing a like distinction. See also *Hayes* v. *Gauley Mt. Coal Company*, 247 U. S. 189, which applied the same principle to stock purchased before the act went into effect and sold thereafter. These cases and Treasury regulations clearly recognize that the accretion, although turned into income at one time, nevertheless accrues to the property over the entire period of years it is held and is not derived from the sale or disposal of the property, although realizament in *Merchants Loan & Trust Co.* v. *Smietanka, infra*, quoted in Appendix, pp. 20-23. In accord with this theory, regulations have, since 1916 provided that bond discount should be amortized by the issuer over the life of the bonds rather than accounted for in the year of issue or redemption. Reg. 33, Art. 150. The 1918 regulations provided similarly for both bond premium and bond discount. Reg. 45, Arts. 544 (2)(a), (3)(a); Reg. 101, Art. 22(a)—18 (1938). It would be otherwise if the profit or loss were derived tion then takes place. See also excerpts from brief of the Governfrom the dealings.

'income,' as used in common speech, in order to determine its meaning in the [Sixteenth] Amendment,"[12a] referred to and adopted the definition of income from *Stratton's Independence* v. *Howbert* and *Doyle* v. *Mitchell Bros.*, both *supra*, specifically including therein "profit gained through a sale or conversion of capital assets . . ."[12b] and this Court then said:

> "Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being 'derived,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description." (p. 207.) (Italics by the Court itself.)

Merchants Loan & Trust Co. v. *Smietanka*, 255 U. S. 509, involved the taxability of capital gains under the Revenue Act of 1916 (passed almost concurrently with the Farm Loan Act in 1916). In combating taxpayer's contention that the profit made was so closely related to the capital as to be still a part thereof rather than income, the United States in its brief (Brief for Deft. in Error, No. 608, O. T. 1920, p. 11) asked this question (see Appendix, p. 21): "The question then is, What, in common speech, is under-

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[12a] The language of Section 26—"income derived therefrom"—stems from the Sixteenth Amendment authorizing taxes upon "income from whatever source derived". The Federal Reserve Act was adopted shortly after the Sixteenth Amendment; and the phrase was used therein to give Federal reserve banks an exemption as broad as the income taxes under the Sixteenth Amendment. See *infra*, pp. 23-24.

[12b] The three classifications of income thus defined by this Court seem to be all-inclusive and have been accepted by the Treasury Department in all of its income tax regulations. Thus Article 51 of Regulation 77 (Revenue Act of 1932) provides that "income is the gain derived from capital, from labor, or from both combined" which includes "profit gained through sale or conversion of capital assets".

stood to be included in income?''; and it answered (pp. 16-17) its own question as follows (Appendix, p. 23):

> ''Income is something separate and distinct from the principal or capital *which produces it.* It is a gain or increase *derived from capital* . . . When property is sold at an advance over what it has cost, the proceeds of sale include both the capital and the income which has resulted . . . *What remains is the income which has been produced by or derived from the capital.''* (Italics added.)

This Court agreed with the analysis of the Government (p. 520):

> '' . . . *it is palpable that it was a 'gain or profit' 'produced by' or 'derived from' that investment,* and that it 'proceeded,' and was 'severed' or rendered severable, from it by the sale for cash, and thereby became that 'realized gain' which had been repeatedly declared to be taxable income within the meaning of the constitutional amendment and the Acts of Congress.'' (Italics added.)

This concept has not been deviated from. In *Taft* v. *Bowers,* 278 U. S. 470, 482, as to property transferred as a gift and thereafter sold by the donee, the increase realized by the sale, the Court said, ''became income *from that investment* in the hands of the recipient . . .'' (Italics added.) And in *MacLaughlin* v. *Alliance Insurance Company,* 286 U. S. 244, 249, 250, decided subsequent to *Willcuts* v. *Bunn,* in construing the 1928 Revenue Act, the Court said:

> ''Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one.''

That the gain came from the sale or dealing, as petitioner now contends, is incompatible with the idea of increase in value to property at any time prior thereto. Compare Department of Justice, *Taxation of Government Bondholders*

and Employees—the *Immunity Rule and the Sixteenth Amendment*, Government Printing Office, 42, 50, 104-5.

It is elementary, of course, that Congress in enacting Section 26 is presumed to have used these words according to their judicial (*United States* v. *Merriam*, 263 U. S. 179, 187) and well-settled meaning. In *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552, 560, this Court said:

> "The rule which should be applied is established by many decisions. 'The legislature must be presumed to use words in their known and ordinary significations.' *Levy's Lessee* v. *M'Cartee*, 6 Pet. 102, 110. 'The popular or received import of words furnishes the general rule for the interpretation of public laws.' *Maillard* v. *Lawrence*, 16 How. 251, 261."

C. This presumption as to the intended meaning of the words is borne out by analysis of the entire Farm Loan Act, which clearly anticipated there would be capital gains. Section 13 (12 U. S. C. § 781, Appendix, p. 2) empowers Federal land banks to buy and sell farm loan bonds, and Section 16 (12 U. S. C. § 813, Appendix, p. 2) extends the same privilege to joint stock land banks; Section 22 (12 U. S. C. § 897, Appendix, p. 4) authorizes the use by both types of banks of certain funds to purchase "at *or below par*" farm loan bonds. Congress used both "interest" and "income" in the Act; the first of these words was used some 41 times in its customary sense as the hiring price of money; the second, however, was used but twice, both times in Section 26. The first sentence of that section provides that "every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and *the income derived therefrom*, shall be exempt from" taxation, etc. There is no question whatever but that as used in this sentence the phrase "income derived therefrom" includes gains and profits of every kind and description, in addition to interest, notwithstanding the fact that these banks and associations must actually purchase and sell in order to realize capital gain, and notwith-

standing the further fact that skill and sagacity, may have played some part therein.

The second sentence, in providing that "farm loan bonds issued under the provisions of this Act * * * shall be deemed and held to be instrumentalities of the United States, and as such they and 'the *income derived therefrom*' shall be exempt from" taxation, etc., used the same precise words, and should therefore also comprehend capital gains. In fact the General Counsel of the Bureau of Internal Revenue so held in the Des Moines opinion, in the course of which he said (Ex. 6, R. 85, 91-92):

> "It would be inconsistent to define the words 'income derived therefrom' found in the third line of Section 26, to include profits or gains, while at the same time defining the same words found in the tenth line of the same section, to include only interest."

Commenting on that language the Circuit Court below said simply: "That reasoning continues sound." (R. 131.) Indeed this meaning was never questioned until the present case arose, and even then the exemption was denied upon a different theory long since exploded and abandoned.[13]

Furthermore, it stands admitted by petitioner herein that the exemption clause of the second sentence of the section is broader than would have been necessary had Congress intended to exempt interest only. See petition for certiorari, page 4:

> "While in Section 26 of the Federal Farm Loan Act of 1916, *infra,* Congress used the *relatively broader clause* [italics added] exempting the bonds 'and the income derived therefrom' instead of the *interest* derived therefrom, it was never intended that gains derived from dealings in the bonds should be exempt."

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[13] The theory was that respondent could not have the benefit of the exemption even though the bonds and the income derived therefrom were exempt, because he was not himself a "federal agency". See Exhibit 10, R. 106-7. Petitioner has not attempted to sustain this theory in either of the lower courts or here.

What this "relatively broader clause" could possibly include beyond interest unless it be capital gains, petitioner has not shown.[14] It is reasonable to assume that if Congress intended to exempt interest only, it would have very simply said so by using that word. By the same token, it is reasonable to assume that having used the generic term "income" it intended to exempt all income having the bonds as its source. Certainly the efforts of petitioner to limit the scope of the second sentence of Section 26 would require this Court to depart from the rule that the "plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect could discover." *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370; *Deputy* v. *duPont*, 308 U. S. 488, 498.

D. The meaning for which we contend is reinforced by comparing the language of Section 26 with other exemption statutes. Had Congress wanted to exempt only interest on farm loan bonds it had precedent for language to use at least as early as 1870;[15] or it could have followed, even

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[14] The author of the majority opinion in the related case, *Agricultural Securities Corp.* v. *Commissioner*, 39 B. T. A. 1103, 1107, purported to find justification for the language used through reference to the receivership provisions of the Farm Loan Act in "periodical payments to bondholders resulting from" receivership operations of bank properties. What the Member overlooked was that well over half of the income there involved was of exactly that type, which under his own reasoning was exempt—as would be over 90 per cent of the income involved herein. R. 30-31. Petioner, however, has not adopted that theory. On the contrary, while admitting the breadth of the language used, but remaining silent as to the reason therefor, the Government frankly argued before the Eighth Circuit that "the true and proper construction of the exemption phrase 'they and the income derived therefrom' of the Federal Farm Loan Act is that 'they' refers to principal of the bonds and 'income' refers to interest." See respondent's brief, p. 4, *Stern Bros.* v. *Commissioner*, *supra*. And that seems to be the essence of petitioner's present position.

[15] Act of July 14, 1870, c. 256, 16 Stat. 272, § 1, quoted along with other exemption statutes, Appendix, p. 7.

closer than it did, the Federal Reserve Act of 1913. That act, while exempting *income* derived from capital, reserve and surplus,[16] gave exemption to treasury notes only "as to principal and interest."[17] But this Congress did not do; it chose the same measure of exemption for bond and mortgage income that it did for capital and surplus income.

The same discrimination in language is discernible in other exemption statutes and throughout the years. For the liberty loan issues, coming very shortly after the Farm Loan Act, being direct obligations of the Government, only interest—sometimes only part of the interest—was exempted.[18] But for its various agencies Congress has apparently always felt that full exemption of all their income was advisable[19] even though at times it has exempted only interest on their debentures.[19a] In such statutes there are clearly expressed two measures of exemption. But for some agencies, not only has the income from their capital and surplus been made exempt, but also income from their bonds and debentures.[19b] Thus, after all the liberty loan acts, and with them and other statutes as precedents for narrower language, Congress nevertheless in 1923 extended to all intermediate credit banks, their capital, reserve and surplus, their bonds and mortgages, "and the income derived therefrom" the identical exemption contained in Section 26 of the Farm Loan Act.[19c] Again, in 1934, this was done in the Farm Mortgage Corporation Act,[19d] and yet again in 1938

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[16] 38 Stat. 258; see Appendix, p. 11. See also discussion of this Act as the source from which the language of Sec. 26 came, *infra*, pp. 23-4.

[17] 38 Stat. 269; see Appendix, p. 8.

[18] See Appendix, pp. 8-10.

[19] See Appendix, p. 11.

[19a] See Appendix, pp. 12-16.

[19b] See Appendix, pp. 17-19.

[19c] 42 Stat. 1459. See Appendix, p. 17.

[19d] 48 Stat. 360. See Appendix, p. 18.

for the Commodity Credit Corporation and its debentures.[19e]

Had this occurred but once a reasonable doubt might be entertained as to its special significance. But recurring as it did repeatedly over a long period of years, in the face of ample precedent for choice of narrower language, and in the face of concurrent enactment of other exemption statutes using both broader and narrower language simultaneously, it has a legislative significance which cannot be ignored. It discloses a clear intention on the part of Congress to draw distinctions and to shape the respective exemptions to suit its differing policy to the different circumstances with which it was dealing. There can be no question that where the statutes refer to and exempt only interest, they have a narrower meaning than where they refer to and expressly exempt income. Unquestionably in the latter instances and in the absence of qualification, they include every kind of income, among which is capital gain as well as interest. As this Court has recently said in *Helvering* v. *Wood*, 309 U. S. 344, 347:

> "Whether as a matter of policy such nice distinctions should be perpetuated in a tax law . . . is not for us. We have only the responsibility of carrying out the Congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it."

E. There was sound reason for Congress to exempt capital gains from taxation. Faced with the farm crisis of 1912-13, the same Congress which under the Sixteenth Amendment passed the first income tax law of 1913, authorized the President to appoint a commission to study the field of rural credits.

The problem of the Commission (called the United States Commission) was to alleviat the crisis by providing long-term money to farmers at low rates of interest.

[19e] 52 Stat. 108; see Appendix, pp. 18-19.

Low rates to farmers could be insured if a supply of money at low rates to the banks could be guaranteed. The act provided (Secs. 12 and 16) that farmers could be charged on the money they borrowed only 1 per cent more than the land banks paid for money borrowed from investors. The ultimate problem, therefore, was that of making farm loan bonds attractive for investment purposes as against industrial issues and Government bonds.[20] To accomplish this, a plan had to be devised to insure a ready market—one that would be maintained both as to old and as to new issues as the best security against inadequate new funds and rising interest rates. If, for example, a bond already issued should drop appreciably below par, new bonds to be issued by the same bank would be compelled to pay a sufficiently larger rate of interest to make up the loss, and farmers who borrowed the new money would automatically have to pay a higher rate of interest.

Thus the supplemental statement of the Commission (H. R. Doc. 679, 63d Cong. 2d Sess., p. 16)[22] states:

> "Each bank is also authorized to deal in national land-banks bonds of other farm-land banks with its deposits. This will enable the bank with a large capital, located in a section where money is plentiful, to purchase and trade in the national land-bank bonds issued by banks in less favored sections, and thereby to main-

[20] H. R. Rep. No. 630, 64th Cong., 1st Sess., Parts 1 and 2, House Committee on Banking and Currency; Sen. Rep. No. 144, Senate Committee on Banking and Currency, 64th Cong. 1st Session. Report of U. S. Commission, Sen. Doc. No. 380, 63d Cong., 2d Sess.

[22] The Commission also states, *op. cit.*, p. 24:

> "This provision encourages the farmer to buy the national land-bank bonds of that bank when they fall below par, because thereby he can pay off his mortgage at less than its face. Such a provision will tend to maintain the market for the national land-bank bonds. Likewise the bank itself can buy its bonds in the market, cancel the same, and thereby release its proportionate part of the mortgages securing such issue. This likewise tends to encourage the bank to invest its surplus funds in its own national land-bank bonds, and tends to maintain the market."

> tain the market for its securities, and to use the funds available in one section of the country to meet the needs in other sections."

It should be sufficiently clear[23] that Congress considered a steady market and liquidity of the bonds a first essential to the success of the system.

Direct Federal aid and Federal guarantee of the bonds were considered but were recommended against.[24] The remaining alternative, and the one seized upon, in addition to prescribing certain safeguards against over-issuing bonds on the security available, was the granting of an extremely wide tax exemption. And it was not sufficient that this tax exemption should apply only to "interest", for investors could already purchase government bonds backed by the entire credit of the Government, on which interest was exempt. Rather, in order to give the bonds an advantage over other securities, it was considered necessary to make the exemption apply to all income connected with the new bonds. This was confirmed by Senator Hollis, in charge of the bill in the Senate (Cong. Record, Vol. 53, Part 8, p. 7312):

> "It would be futile—it would be useless—to pass this law unless we had given these investments a distinct advantage over other investments. They will have it; they ought to have it; and if this bill is passed, they will get it."

Hon. Ralph W. Moss, senior member of the House group on the joint sub-committee and who had been vice-chairman of the U. S. Commission, also so understood. Said he:

> ". . . the system rises and falls with this one paragraph of the bill [referring to what became Section 26]. . . . So the point I want to make clear is, that I am . . . making as strong an argument as I possibly can in favor

[23] See discussion of Farm Loan Act provisions, *supra*, pp. 16-17.

[24] Sen. Doc. 380, 63d Cong. 2d Sess., Parts I, II, p. 22; H. R. Doc. 679, 63d Cong., 2d Sess., p. 5; Cong. Rec. Vol. 53, Pt. 7, p. 6793.

of the exemption of the land mortgage and the land bond. And unless the committee sees fit to extend that exemption so far, you had just as well throw the bill in the wastebasket.

". . . there was no one feature of the bill to which so much thought was given as the question of exemption from taxation." (Hearings [joint] before Sub-Committee of Committees on Banking and Currency of the Senate and House of Representatives on Rural Credits, 63d Cong. 2d Sess., pp. 97-98).[26]

As against this theory of the legislature, petitioner (footnote, p. 11) asserts that whether the exemption from capital gains would make these bonds an attractive investment, is a "matter of mere speculation" because such exemption would "as a necessary concomitant, deprive investors of a deduction for losses on sales." The majority opinion in *Agriculture Securities Corp.* v. *Commissioner,* 39 B. T. A. 1103, makes the same argument.

The answer is two-fold: (1) Congress did not think the matter one of speculation, as evidenced by its action; (2) there is, so far as counsel have been able to discover, no statutory basis for the statement that an exemption as to capital gains would prevent a deduction as to capital losses. The statement in *Willcuts* v. *Bunn,* 282 U. S. 216, 231, relied on by petitioner, was itself a speculation by the Court as to the possible situation if Congress should so legislate and it does not seem to have any actual support in the statutes.

F. Examination of the legislative history of Section 26 further corroborates the intention to exempt capital gains on farm loan bonds. It must be borne in mind that the Sixteenth Amendment and the first income tax laws thereunder were new at this time, virtually contemporaneous with this farm loan legislation. Congress was not only decidedly income-tax-conscious, it was also conscious of the advantage it could give any new and favored project through exemp-

[26] See also testimony of Secretary of Treasury on the wider exemption enjoyed by these bonds than liberty bonds, *infra,* p. 29.

tion from the new tax. In 1913 it had done this very thing for the newly created Federal Reserve System, 12 U. S. C. § 531:

> "Federal Reserve banks, including the capital stock and surplus therein, *and the income derived therefrom* shall be exempt from Federal, State and local taxation except taxes upon real estate." (Dec. 23, 1913.) (Italics added)

This language was used for the avowed purpose of exempting the new banks from the newly enacted income tax law.[27] By reason of it Federal reserve banks have consistently been held exempt as to all their income, including capital gains; the exemption has even been held to extend to dividends on stock in the hands of member banks. Bulletin 1916 Federal Reserve Board, p. 153.

Three years later, for its new project to aid farmers, Congress lifted this language bodily from the Federal Reserve Act.[28] In doing so, Congress necessarily attached to it the same meaning that it had in the Federal Reserve Act itself.[29]

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[27] See H. R. Rep. No. 69, Committee on Banking and Currency on Federal Reserve Banks, 63d Cong., 1st Sess. p. 39:

> "In view of the increasing burden of taxation *and of the Federal income-tax law which now furnishes an additional draft upon net earnings,* this exception is likely to prove of material importance * * *." (Italics added)

[28] See Report of the United States Commission, Sen. Doc. 380, 63d Cong. 2d Sess., Parts I and II, p. 33; Statement of Representative Moss in charge of bill in House, in Joint Hearings before Sub-Committees, Senate and House on Rural Credit, 63d Cong., 2d Sess., p. 97; Report of the United States Commission on National Farm Land Banks, H. R. Doc. 679, 63d Cong. 2d Sess., p. 18; the latter is a supplemental report of the U. S. Commission.

[29] *Hecht* v. *Malley,* 265 U. S. 144, 153 (citing cases); *Sessions* v. *Romadka,* 145 U. S. 29, 43. This is confirmed by the statement of Rep. Moss and Senator Hollis, in the course of the Joint Hearings before the Sub-Committee of the Committee on Banking & Currency, 63d Cong. 2d Sess., p. 95:

> "Mr. Moss: That provision in the bill was taken from the regional-bank [Federal reserve bank] provision, and the exact

The idea of complete exemption of both banks and bonds from taxation did not, of course, spring into being full-blown. (See Appendix pp. 24-26.) It was a natural growth which discloses how acutely conscious Congress was of the tax exemption feature. As originally written, the exemption of farm loan bonds specifically excluded income tax; it extended to "any tax, assessment, or charge (*other than income tax*) whether national, state or municipal." [30] (Italics added.) This was broadened after further study to exempt the national land banks bonds "from Federal, state and local taxation, except in respect to taxes upon real estate." [31] Senator Hollis, in charge of the legislation in the Senate, was in favor of exempting the banks from the income tax, whereas Representative Moss, in charge of the legislation in the House, was at first opposed, although ardently for the exemption of the bonds.[32] The matter was

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language contained in that act was written here to extend the same favor to those [farm loan] banks which is shown to the regional [Federal reserve] banks, without creating any precedent.

"Senator Hollis: You see we did not need to encourage the incorporation of national banks, because we already have 7,500 of them; but here we are undertaking to go into a new field and encourage the establishment of banks that are sorely needed, and therefore I think we should have this exemption * * *" (Italics added.)

[30] Senate Committee Hearings, Committee on Banking and Currency, 1913-15, Vol. 35, p. 832.

[31] It was at this point that the words "income derived therefrom" were first used by the draftsman. The entire section, as it then stood, was as follows (Report of the United States Commission, Sen. Doc. 380, 63d Cong. 2d Sess., Parts I and II, p. 62):

"Section 18. That every national farm-land bank incorporated under the terms of this Act and the capital stock and surplus therein and the income derived therefrom and the mortgages and deeds of trust (and the notes and bonds secured thereby) held by said bank and the national land-bank bonds issued by the same shall be exempt from Federal, State, and local taxation, except in respect to taxes upon real estate."

[32] Hearings before Joint Sub-Committee, Committees on Banking & Currency, on Rural Credits, 63rd Cong., 2nd Session, pp. 95-97.

compromised by the extension of the same exemption to banks and bonds. When the bills were introduced in the Senate[33] and the House[34] simultaneously thereafter, they contained a provision that "Farm loan bonds issued under the provisions of this act and the income derived therefrom shall be exempt from Federal, state and local taxation." The language finally enacted was adopted in the report of the Senate Committee on Banking and Currency.[35] Selection of the language finally adopted is further emphasized by the simultaneous rejection of two bills, one by Senator Norris[36] and one by Senator Gronna,[37] which were offered as substitutes for the committee bill, and each of which exempted only interest on bonds and mortgages.

There was general agreement in the debate that Congress was adopting the broadest possible exemption in order to promote its policy with respect to the legislation.[38] These expressions came alike from those who favored the exemption and those who opposed it; and the unanimity with which the breadth of the tax exemption provision was viewed is persuasive. *Federal Trade Commission* v. *Rala-*

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[33] S. 289, 64th Cong. 1st Sess., Sec. 29.

[34] H. R. 15004, 64th Cong. 1st Session, Sec. 23; H. R. 630, 64th Cong. 1st Session.

[35] S. Report 144, 64th Cong. 1st Session, p. 32 on S. 2986.

[36] S. 4061, 63 Cong., 2d Sess.

[37] Printed in 53 Cong. Rec. Part 8, pp. 7385-8; see § 24, p. 7387.

[38] In addition to the expressions of Mr. Moss quoted above and Senator Hollis, see that of Senator Lodge of Massachusetts as to total tax exemption, 53 Cong. Rec. p. 7128; Senator Cummins of Iowa, *Id.* p. 7311; Governor Herrick of Ohio in letters to Senator Harding introduced into the Record, *Id.* p. 6850; Senator Hollis, *Id.* p. 6851, 6696-7; Representative Moss in hearings before the joint sub-committee of the Committee on Banking and Currency, 63d Cong., 2d Sess., p. 95-7. Compare statement of C. C. Atcheson, one of the agricultural experts for the period of the hearing and who protested the exemption of income tax upon profits of individuals, Joint Hearing, *supra*, p. 263-264. These are collected in the Appendix, pp. 26-29.

dam Co., 283 U. S. 643, 649-651; *Humphrey's Executor* v. *United States*, 295 U. S. 602, 625.

The consistent course of Congress in this connection is recognized in the Act of May 12, 1933, c. 25, § 29, 48 Stat. 46, 12 U. S. C. § 810, which provided for the liquidation of joint stock land banks, and Sec. 817 of the Revenue Act of 1938 dealt with at length below pp. 34-39. These banks had, according to the Congressional view, served their purpose, and by the act first named had been forbidden to make any loans to farmers or to issue new bonds except in liquidation of pre-existing loans or bonds. There was, therefore, no need, so far as these banks were concerned, longer to encourage the maintenance of high market prices for their bonds. Consequently Congress by Section 817 of the Revenue Act of 1938 reversed its prior policy and provided with respect to all bonds to be thereafter issued by joint stock land banks (but not those to be issued by Federal land banks) that "all income, except interest" should be taxable.[39]. The exemption as to bonds issued by Federal loan banks was of continued necessity by reason of the added responsibility on the Federal land banks to loan money to farmers at low rates. Congress also continued the total exemption with respect to bonds of intermediate credit banks (42 Stat. 1459) and to mortgages and bonds of the Federal Farm Mortgage Corporation (48 Stat. 360) although it had been proposed to the Finance Committee that the total exemption be withdrawn as to the bonds of all these agricultural corporations (Hearings before the Committee on Finance, U. S. Senate, 75th Cong., 3d Sess. on H. R. 9682, Part 4, pp. 614-619). And finally, the very Congress which in 1938 amended Section 26 as to

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[39] The Farm Loan Act of 1916 set up two different kinds of land banks (1) the Federal land banks patterned in some respects after the Federal Reserve System, with the United States as direct owner of stock which was unsubscribed when the system was inaugurated (Farm Loan Act, Sections 4 to 15); (2) the Joint Stock Land Banks owned strictly by private enterprise (Farm Loan Act, Section 16 *et seq.*).

joint stock and land bank bonds, granted an exemption to the Commodity Credit Corporation couched in the identical language of the original Section 26.[40] Intermediate credit banks, the Commodity Credit Corporation, and the Federal Farm Mortgage Corporation, like the Federal land banks, are current institutions with contemplated future activity, as contrasted with joint-stock land banks, which had become moribund.

G. The fact that the words "income derived therefrom" include capital gains has been consistently (with the exception of the ruling in the present case) observed by the administrative branch of the Government. That phrase as used in the Federal Reserve Act of 1913, and as used in the first sentence of Section 26 since 1916 has been interpreted to exempt Federal reserve and Federal land banks from paying a tax on any income. These banks do not even file income tax returns. We are also informed by the other agencies to which the same exemption has been accorded (Federal Reserve banks, Federal Intermediate Credit bank, Federal Farm Mortgage Corporation and the Commodity Credit Corporation) that they do not pay taxes upon any of their income including capital gains, or even file income tax returns.[41]

The construction of the phrase "income derived therefrom" contained in the second sentence of Section 26 has been to the same effect. Thus, under the "duty" placed upon the Farm Loan Bureau by Section 3 of the Farm Loan Act "to prepare and distribute . . . circulars . . . advising investors of the merits and advantages of Farm Loan Bonds," (12 U. S. C. § 664 that Bureau from the beginning distributed circulars in which it was represented to the public that the bonds and their income were "free from all forms of taxation" including "income tax and all

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[40] Act of March 8, 1938, c. 44, 52 Stat. 107, 108, § 5.

[41] The exemption contained in this first sentence of Section 26 has been construed by the Treasury Department to extend even to interest on promissory notes executed by Federal land banks when they borrow money. (Cf. IT. 1806, C. B. II-2, 92, 1923.) For exemption statutes covering the above named agencies, see Appendix hereto, pp. 17-19.

forms of State and municipal tax of every kind and character," etc. (R. 42)

As early as two years after the passage of the Farm Loan Act, the Secretary of the Treasury answered the question here involved. During the course of a Congressional hearing on the Revenue Act of 1918, in response to a question as to why the Treasury was not then selling farm loan bonds he replied:

> "(Secretary McAdoo): The only reason they have not been sold this year was because I did not want to set up competition between the land banks and the Treasury Department in the sale of securities. Land bank bonds carry a wider exemption than liberty bonds." (Senate Hearings, H. R. 12863, part 2, page 117, 65th Cong., 2d Sess).

Since at that time some of the Liberty Loan Bonds outstanding exempted principal and all interest from taxation, the Secretary must have understood that farm loan bonds also exempted capital gains—the only other kind of income possible.

This understanding was reiterated by the General Counsel of the Bureau of Internal Revenue on May 2, 1933. On that date, in response to an inquiry from the Des Moines Joint Stock Land Bank he ruled that capital gains made by that taxpayer on dealings in its own bonds were exempt (Ex. 6, R. 85), see supra, p. 17. This ruling was duly circularized to all banks (Ex. 7, R. 94). It has never been overruled, but on the contrary has been recognized to cover also gains made by banks on bonds of other banks (R. pp. 95-6). Through such dealings, joint stock land banks have netted profits in excess of a hundred million dollars (R. pp. 100-1), all of which has been held exempt (R. p. 101) and statutory closing agreements with at least seven banks so profiting, under which it was agreed that no taxes were due, were entered into under the provisions of Section 606, Revenue Act of 1928, said agreements being dated as late as July 23, 1936, and June 8, 1937 (Ex. 8, R. 99-100). The

attempt of the taxing authorities to tax the present taxpayer, after having exempted from taxation profits of the same kind made by joint stock land banks, aggregating over one hundred million dollars, is, we submit, discrimination of a kind that this Court should not permit.

Furthermore, when, pursuant to Act of May 12, 1933, (C. 25. §29, 48 Stat. 46) joint stock land banks were required to liquidate and were selling their mortgages to the public, another ruling was handed down by the General Counsel of the Bureau of Internal Revenue that the exemption of income derived from mortgages issued to joint stock land banks, and by them sold to individuals, continued in favor of the purchasers (Ex. 9, R. 103). Mortgage income is exempted by the same sentence which exempts bond income.

The author of the majority opinion in *Agriculture Securities Corp.* v. *Commissioner* (1939), 39 B. T. A. 1103, 1111-1112, dismissed the matter of administrative construction on the ground that it was neither uniform nor of long standing. Apparently it was not regarded by the Member as uniform because in the present case a cavalier memorandum had been written, in which (Ex. 10, R. 106), while the earlier opinion was not repudiated, it was sought to be distinguished as dealing with the incomes of banks and not those of individuals.[42] If, in a given case, any tax collector, in the face of long continued and well settled administrative construction, could prevent that construction from being "uniform" by merely making a contrary determination, then no taxpayer could ever rely on administrative construction no matter how cogent its reasoning, however many times re-affirmed, or how long continued it may have been. This Court is aware that the doctrine itself is of effect even though the taxing authorities in a particular case assert a view contrary to that previously uniformly held. The Board member overlooked all of the instances of

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[42] See footnote 13, p. 17.

administrative interpretation which we have discussed above except the *Des Moines* opinion, its circulation, and the memorandum issued in this case.

Petitioner would dismiss (Petr.'s Brf. p. 19) as unpublished memoranda not binding on the Department the General Counsel's decision of April 3, 1933 (R. 85-93) and the letter of the Farm Credit Administration of Sept. 12, 1934 (R. 103, 104). But as the record shows, both of these memoranda were duly circularized by the Treasury Department (Farm Loan Bureau) and by the Farm Credit Administration (see Ex. 7, R. 94; Ex. 9, R. 103). They are important not only because they are official determinations of the Government officers charged with the enforcement of the law and by them duly publicized, but because, as the court below said, their "reasoning continues sound", (R. 131) and they are in accord with the well-settled construction above outlined.

It is, of course, elementary that administrative construction such as here exists is entitled to great weight and will not be disturbed except for cogent reasons. *Brewster* v. *Gage*, 280 U. S. 327; *Willcuts* v. *Bunn, supra.* Particularly is this so where, as here, the construction is against the tax asserted and in favor of the person affected. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110; *Lincoln Chemical Co.* v. *Edwards*, 289 Fed. 458, 462; *Edwards* v. *Wabash Ry. Co.*, 264 Fed. 610; *Bowers* v. *West Virginia Pulp & Paper Co.*, 297 Fed. 225, cert. den., 265 U. S. 584.

Moreover, Congress has accepted and ratified the administrative interpretation. This acceptance and ratification consists partly in refusal until 1938 to amend Section 26 in the face of the existing administrative construction, and despite constant amendment of the rest of the act; partly in its extension of the exemption to include other instrumentalities; and finally, of its express recognition of the general counsel's opinion in the *Des Moines* case (R. 85-93 Ex. 6) as correctly stating the law.

From 1916 to 1938 the Farm Loan Act was amended on at least 20 different occasions.[43] And yet although as early as 1918 the Secretary of the Treasury had indicated the breadth of the exemption, Section 26 was not amended in any particular. On the contrary, on at least one occasion, notwithstanding the favorable Committee report, Congress refused to interfere with the exemption. See S. 319 and Report 317, 66th Cong., 1st Sess. of Committee on Banking and Currency. Within less than a year after the publicizing of the Des Moines Opinion, Congress gave comprehensive consideration to the Farm Loan Act, amending it on three different occasions in important respects.[42b] But again no attempt was made to cut down on the scope of the tax exemption. On the contrary, the scope of Section 26 has been extended to other agencies and instrumentalities. See *supra*, pp. 19-20, 27-28.

This long acquiescence has itself amounted to legislative approval. *Helvering* v. *Winmill*, 305 U. S. 79, 83; *U. S.* v.

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[43] Act of January 18, 1918, c. 9, 40 Stat. 431; Act of April 20, 1920, c. 154, 41 Stat. 570; Act of May 29, 1920, c. 215, 41 Stat. 691; Act of February 27, 1921, c. 78, 41 Stat. 1148; Act of March 4, 1921, c. 151, 41 Stat. 1362; Act of July 1, 1921, c. 39, 42 Stat. 105; Act of August 13, 1921, c. 63, 42 Stat. 159; Act of March 4, 1923, c. 252, 42 Stat. 1454, Titles I, II, III; Act of March 4, 1925, c. 524, 43 Stat. 1262; Act of March 4, 1929, c. 700, 45 Stat. 1558; Act of June 26, 1930, c. 613, 46 Stat. 815; Act of March 4, 1931, c. 518, 46 Stat. 1548; Act of January 23, 1932, c. 9, 47 Stat. 12; Act of May 19, 1932, c. 191, 47 Stat. 159; Act of March 4, 1933, c. 270, 47 Stat. 1547; Act of June 16, 1933, c. 98, Title VII, 48 Stat. 257, 269; Act of June 3, 1935, c. 164, 49 Stat. 313; Act of June 24, 1936, c. 762, 49 Stat. 1912; Act of July 22, 1937, c. 516, 50 Stat. 521; Act of August 19, 1937, c. 704, 50 Stat. 703.

See also Act of May 15, 1922, c. 190, 42 Stat. 541, 542, § 3; Act of March 10, 1924, c. 46, 43 Stat. 17, § 2; Act of May 24, 1926, c. 377, 44 Stat. Part II, 628; Act of February 2, 1932, c. 14, 47 Stat. 36.

[42b] Act of May 12, 1933, Title 2, Parts 1, 2 and 3, 48 Stat. 41, 46, 48, 51; Act of June 16, 1933, Title 7 and 8, 48 State. 269, 273; Act of June 30, 1934, 48 Stat. 542.

Dakota Montana Oil Company, 288 U. S. 459, 466; *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S. 289, 293, 294; *National Lead Co.* v. *United States*, 252 U. S. 140, 146.

In *Manhattan Properties* v. *Irving Trust*, 291 U. S. 320, this Court held that the action of Congress in refraining over a period of 34 years from amending a certain portion of the Bankruptcy Act during which time Congress had passed other amendments to the act was persuasive that the construction adopted had been acceptable to the legislative arm of the Government and was tantamount to a legislative interpretation. And see *Sessions* v. *Romadka*, 145 U. S. 29, 41, 42; *Electric Storage Battery Co.* v. *Shimadzu*, 307 U. S. 5, 14, and cases cited therein, note 18.

Moreover, Congress by enacting Section 817 of the Revenue Act of 1938, with the Des Moines opinion, spead upon the minutes of its Finance Committee,[43] affirmatively approved of the interpretation already given.[43a] By that statute Congress provided that as to all bonds issued after that date "*all income, except interest, derived therefrom* shall be included in gross income and shall not be exempt from Federal Income taxation." The Committee in reporting this legislation said that it did not apply retroactively "for constitutional reasons". No matter if theretofore the statute had been doubtful or not, no matter if the representations to the public and the rulings of the department had been positively erroneous, no matter if they covered a long or a short period of time or were not uniform, the issue was definitely and positively decided in favor of the taxpayer by this new enactment. In *Silas Mason Co.* v. *Tax Commissioner*, 302 U. S. 186, 208, this Court held:

> "The federal intent in this instance is clearly shown. It is shown not merely by the action of administrative

[43] Hearings, Senate Committee on Finance, 75th Cong., 3d Sess. on H. R. 9682, Part 4, pp. 64-103.

[43a] See pp. .... to .... hereof.

officials, but by the deliberate and ratifying action of Congress, *which gives the force of law to the prior official action even if unauthorized when taken.*"[44] (Italics added.)

H. That Section 26 exempts capital gains was affirmatively recognized by the legislative branch of the Government in Section 817 of the Revenue Act of 1938 which provides (Revenue Act 1938, C. 289, 52 Stat. 578, 12 U. S. C. Section 931-a, 26 U. S. C. Sec. 3799):

"Notwithstanding the provisions of Section 26 of the Federal Farm Loan Act, as amended, in the case of mortgages made or obligations issued by any joint-stock land bank after the date of the enactment of this

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[44] In *Swayne & Hoyt* v. *U. S.*, 300 U. S. 297, 301, this Court held that:

"It is well settled that Congress may, by enactment not otherwise inappropriate, 'ratify . . . acts which it might have authorized.'"

Even where there is no direct ratification, if such is the fair implication of the Congressional action it is sufficient.

Hamilton v. *Dillin*, 21 Wall. 73; *Mattingly* v. *District of Columbia*, 97 U. S. 687; *Wilson* v. *Shaw*, 204 U. S. 24; *Charlotte Harbor & N. R. Co.* v. *Welles*, 260 U. S. 8. Even if such ratification comes after an action has been filed based on previous invalidity of the administrative act, it is sufficient, *United States* v. *Heinszen & Co.*, 206 U. S. 370; *Tiaco* v. *Forbes*, 228 U. S. 549; *Rafferty* v. *Smith, Bell & Co.*, 257 U. S. 226 for "What the legislature could have authorized, it can ratify if it can authorize at the time of ratification." *Charlotte Harbor & N. R. Co.* v. *Welles*, *supra*. And this is true even if the action of Congress in 1938 were based on an erroneous belief as to what the law was. In *Helvering* v. *Gowran*, 302 U. S. 238, 242, this Court so held:

"The purpose of Congress when enacting Section 115(f) • • • may have been adopted in the erroneous belief that under the rule declared in that case [*Eisner* v. *Macomber*, *supra*] no stock dividend could be taxed. But such facts would not justify the Court in departing from the unmistakable command embodied in the statute."

Act, *all income, except interest*, derived therefrom shall be included in gross income and shall not be exempt from Federal income taxation." (Italics added)

The history of this amendment is as follows:

The hearings before the Senate Committee on Finance (Hearings, Sen. Com. on Finance, 75th Cong., 3rd Sess., on H. R. 9682, Part 4, pp. 614-15) disclose that it had before it for consideration in its search for new revenue sources the suggestion that the exemption theretofore given by three statutes to capital gains on various bonds and mortgages be removed, limiting them to the same exemption conferred on government bonds. The three statutes referred to were the Farm Loan Act here involved, the Intermediate Credit Bank Act of 1923, and the Farm Mortgage Corporation Act of 1934. (See Appendix, pp. 17-19)[44a]

After consideration, however, the committee recommended to the Senate the elimination of capital gain exemption on joint-stock land bank bonds only, leaving the exemption on the others unchanged. The proposed amendment read:

816. "Notwithstanding the provisions of Section 26 of the Federal Farm Loan Act, as amended, gain realized on the acquisition by a joint stock land bank of obligations issued by it or mortgages made by it, if such

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[44a] An amendment to the Revenue Act to accomplish this was proposed as follows, op. cit.:

"All income, except interest, derived from mortgages or farm-loan bonds, issued hereafter pursuant to the provisions of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 380), as amended, the Federal Intermediate Bank Act of March 4, 1923 (42 Stat. 1459), as amended, and the Federal Farm Mortgage Corporation Act of January 31, 1934 (48 Stat. 344), as amended, shall be included in gross income; and all acts pertaining to said mortgages and bonds are hereby amended accordingly."

> obligations or mortgages are made or issued after the date of the enactment of this act, shall not be exempt from federal income taxation."

In its report on the bill, the committee stated that "gain realized on such purchase [and sale at a profit] is, under law taxable income and in the case of an ordinary corporation is taxed. Under the Federal Farm Loan Act which governs the taxability of obligations of joint stock land banks, such income is exempt."[45]

As to this affirmative statement of understanding, petitioner quibbles, by saying (Petr.'s Brf. p. 17) that:

> ". . . insofar as it [Sec. 26] affects the taxation of capital gains of other than joint stock land banks themselves, its purpose was clarification, rather than change."

But petitioner overlooks the legislative history of this section. The committee report above quoted explicitly states that "*such income is exempt,*" not that only such income to joint-stock land banks was exempt. And during the reading of the Revenue Act in the Senate, paragraph by para-

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[45] The entire statement of the Committee on this is as follows:

> "It has been brought to the attention of the Committee that these banks have been purchasing their own bonds at below par and issuing new bonds at or above par. Gain realized on such a purchase is, under the law, taxable income and in the case of an ordinary corporation is taxed. Under the Federal Farm Loan Act, however, which governs the taxability of obligations of joint stock land banks *such income is exempt.* The Committee is of the opinion that such income ought to be taxed. A similar situation exists with respect to mortgages issued by such banks and acquired at less than cost. *For constitutional reasons the provision is confined to gains realized upon bonds and mortgages issued after and acquired after the date of the enactment of the bill.*" (Italics added.)

graph, the ranking Democratic member (Mr. King) of the Committee on Finance made this statement:

> "Mr. President, with respect to the amendment just agreed to, Section 816, my attention has been called to the fact that perhaps the language is not as broad as it should be, and it is now being considered by the Treasury officials. Before we conclude the consideration of the bill I shall offer an amendment to broaden and amplify the provision."[46] (Cong. Rec. Vol. 83, 75th Cong. 3d Session, p. 6504). (Italics added)

Two days later the same Senator offered an amendment to Section 816 which was agreed to and became Section 817 of the enacted law. It was officially explained as follows (Cong. Rec. Vol. 83, 75th Cong. 3d Session, p. 6765):

> "The bill as reported [Section 816] subjected to Federal income taxation capital gains realized by a joint-stock land bank on obligations issued and mortgages made by it after the date of the enactment of the act. *The effect of the amendment* [to Sec. 816, and passed as Sec. 817] *is not only to tax that gain but also to tax gain realized by another joint-stock land bank or by an individual or corporation which itself is not exempt from Federal taxation. Thus, gain on a sale of such a joint-stock land bank bond by an investor is subject to tax.* The amendment continues the present provision of law under which interest on such bonds and mortgages is exempt from Federal taxation." (Italics added)

This discloses a purpose to amend Section 26 and limit the exemption granted therein to obligations issued by joint stock land banks after May 28, 1938. Conversely it dis-

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[46] *Cf. Hassett* v. *Welch*, 303 U. S. 303, 310:

> "Bearing in mind that the resolution was prepared and its passage recommended by the Treasury, the administrative interpretation supports in uncommon measure the view that it was not intended to operate upon transfers completed prior to its passage."

closes the purpose and intention that Section 26 and the exemption therein granted should continue as to obligations issued before May 28, 1938.

Thus, Congress declares as to joint stock land bank bonds issued after May 28, 1938, that "All income, except interest, derived therefrom, *shall be included* in gross income and *shall not be exempt* from Federal income taxation." (Italics ours) and conversely paraphrasing the language of Section 817, it declares as to all such bonds issued prior to May 28, 1938, that "all income derived therefrom *shall not be included* in gross income, and *shall be exempt* from Federal income taxation." (Italics ours)

If, as the Government contends, capital gains were taxable under the language of Section 26, why the necessity of this amendment? Or if, as the Government contends, Section 26 was construed by the succeeding Revenue Acts to exempt only interest, why the necessity of this amendment? As stated by Mr. Justice Sutherland in *Mid Northern Oil Co.* v. *Walker*, 268 U. S. 45, 48:

> "It fairly cannot be supposed that Congress would indulge in the altogether idle ceremony of enacting a law to save rights which, being in no way challenged or affected, stood in no need of being saved."

The legislative interpretation is entitled to great weight. *United States* v. *Freeman*, 3 How. 556, 564-565, states the rule as follows:

> "if it can be gathered from a subsequent statute *in pari materia*, what meaning the legislature attached to the words of a former statute, they will amount to a legislative declaration of its meaning, and will govern the construction of the first statute. [Citing cases] . . . This court has repeatedly, in effect, acted upon the rule, and there may be found, in the reports of its decisions, cases under it, like the cases which have been cited from the reports of the English courts. In 4 Dall., 14, 'The intention of the Legislature, when discovered,

must prevail, any rule of construction declared by previous acts to the contrary notwithstanding.' "[47]

Petitioner attempts to combat this legislative interpretation by cases cited for the proposition that imposition of a tax by a later act is not a Congressional declaration that the subject was not taxed theretofore. The cases cited involved situations where the history of the particular later acts showed affirmatively that the new act was not the declaration of a new policy (*Jordan* v. *Roche*, 228 U. S. 436, 441; *Hartley* v. *Commissioner*, 295 U. S. 216, 220-221), or was affirmatively shown to have been intended to be merely declaratory of existing law as administered (*Helvering* v. *Twin Bell Oil Syndicate*, 293 U. S. 312, 322), or where the new provision went further than the former decisions, so that it was intended to extend as well as clarify the existing law (*Higgins* v. *Smith*, 308 U. S. 473, 479-480), or where the legislative purpose was shown not to have changed when variations of language occurred in the later act, so that the new words were a mere clarification of existing law (*Helvering* v. *New York Trust Co.*, 292 U. S. 455, 468-469).

Such cases have no application here. The language of the committee quoted above—to say nothing of the balance of the legislative history of §817—admits of no doubt as to how the legislators who adopted §817 regarded the meaning of the words "income derived therefrom" in §26 of the Farm Loan Act. Section 817 is clearly *in pari materia* with §26 of the Farm Loan Act, and as such is properly to

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[47] To the same effect are *Alexander* v. *Mayor, etc.*, 5 Cranch. 1, 7-8; *Matthews* v. *McStea*, 91 U. S. 7, 12-13; *New York, P. & N. R. Co.* v. *Pennsylvania Exchange*, 240 U. S. 34, 39; *Cope* v. *Cope*, 137 U. S. 682, 688; *Tiger* v. *Western Investment Co.*, 221 U. S. 286, 309; *First Natl. Bank* v. *Missouri*, 263 U. S. 640, 658-9; *Swigart* v. *Baker*, 229 U. S. 187, 197; *Sarlls* v. *United States*, 152 U. S. 570, 576-7; *Pompton* v. *Cooper Union*, 101 U. S. 196, 201-202; *Farmers', etc. National Bank* v. *Dearing*, 91 U. S. 29, 36; *License Tax Cases*, 5 Wall. 462, 473; *Spencer* v. *United States* (8 C. C. A. 1909) 169 Fed. 562, 564; *Barber Asphalt* v. *Denver* (8 C. C. A. 1896) 72 Fed. 336, 345.

be employed as an aid to statutory construction. See cases *infra*, and Petr.'s Brf. p. 11, note 7.

I. The Farm Loan Act, containing Section 26, became law on July 17, 1916. On Sept. 8, 1916, less than two months later, Congress passed the Revenue Act of 1916 which by Section 4 enumerated various bonds on which interest was exempt, one of which was "securities issued under the provisions of the Federal Farm Loan Act." Revenue acts since that time have contained a similar provision.[47a]

In the court below, and in other similar cases, petitioner contended that even if Section 26 originally exempted capital gains, the exemption as to income other than interest was impliedly repealed by these provisions of the Revenue Act. In this Court petitioner apparently abandons that contention. (*Cf.* Petr.'s Brf. p. 5, 10-11).[48]

[47a] See App., pp. 4-6.

[48] The point is properly abandoned since it was without foundation. The revenue acts, commencing with the Revenue Act of 1916, c. 463, 39 Stat. 756, have provided (§22, 39 Stat. at p. 776) that special provisions of law not specifically repealed and not inconsistent are extended and made applicable to the taxing statute—thus evincing an intent not to repeal. Repeals by implication are not favored. *Morris* v. *Arthur*, 95 U. S. 144, 146; *Rodgers* v. *United States*, 185 U. S. 83, 87-89; *State* v. *Stoll*, 17 Wall. 425, 436; *Ex parte Crow Dog*, 109 U. S. 556, 570; *United States* v. *Nix*, 189 U. S. 199, 205. And an intent to repeal must be found, as in an irreconcilable conflict or by virtue of the later statute's covering the entire ground of the earlier one. *Red Rock* v. *Henry*, 106 U. S. 596, 601-602; *Posadas* v. *National City Bank*, 296 U. S. 497, 503 *et seq.*; *Graham* v. *Goodcell*, 282 U. S. 409, 425-426; *Washington* v. *Miller*, 235 U. S. 422, 428; *Frost* v. *Wenie*, 157 U. S. 46, 58; *Morf* v. *Bingaman*, 298 U. S. 407, 414. Where both acts are affirmative (*United States* v. *Gillis*, 95 U. S. 407, 416), the earlier, special act is read as an exception to the later, general revenue act. See *Rodgers* v. *United States; Washington* v. *Miller*, both *supra*. The Revenue Act, in merely summarizing the exemptions of interest from tax, obviously did not cover the whole field of Section 26, let alone the entire field covered by the Farm Loan Act. In the Revenue Act of 1916, Congress did not undertake to undo what it had just done a few weeks earlier in the Farm Labor Act. *Cf. Graham* v. *Goodcell; Morf* v. *Bingaman*, both *supra*. Since the exemptions contained in

Instead, petitioner now asserts that the revenue acts constitute a legislative interpretation of Section 26 to the effect that Congress thought it had exempted only interest. This contention is also unsound. There is nothing in the legislative history of Section 4 of the Revenue Act of 1916 or succeeding statutes to show that it was intended as an interpretation of Section 26. Neither does the language of the Revenue Act indicate any such intention. To paraphrase the statement of Mr. Justice Holmes in *United States* v. *Stafoff*, 260 U. S. 477, 480 "This section [§4] is not declaratory even in form. It does not purport to construe" Section 26. It is apparent from the structure of the various revenue acts that all Congress intended to do by Section 4 was to summarize in one convenient place exemptions pertaining to interest on government instrumentalities, and

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both acts are not inconsistent, they can and should both function together.

A consistent line of administrative and judicial interpretation demonstrates that the revenue acts are not the sole source of exemptions, and do not repeal earlier special statutes granting specific exemptions. See Regulations 45, Art. 71; Regulations 74, Art. 81, and, generally, see Regulations 74 and 77, Arts. 85 to 90, inclusive, for references to specific acts as sources of exemptions, rather than to provisions of revenue acts; as to Federal Reserve Banks, see Regulations 62 and 45, Art. 76; Regulations 74, Art. 86; Regulations 77, Art. 86; as to annuities stated generally by the Revenue Act to be included in gross income but excepted by virtue of an earlier statute saying they should not be subject to any tax, see Office Decision (I. T.) 3069, CB 1937-1, p. 59; as to veterans' compensation, see I. T. 2655, XI-2 CB p. 19; I. T. 2779, XIII-1 CB p. 37; as to exemptions of Indians and Indian tribes despite tax statutes imposing a tax on "every individual", see 35 Opp. Atty. Gen. 107 (and opinion cited therein); 34 Opp. Atty. Gen. 275, Treas. Decision 3570, III-1, CB p. 85; 34 Opp. Atty. Gen. 439, Treas. Decision 3754, IV-2 CB p. 37; *Blackbird* v. *Commissioner Int. Rev.* (C. C. A. 10th, 1930), 38 F. 2d 976; *Homeratha* v. *United States* (W. D. Okla., 1930), 40 F. 2d 305, app. dis. (C. C. A. 10th, 1931), 49 F. 2d 1086; *Dick* v. *Commissioner* (C. C. A. 10th, 1935), 76 F. 2d 265, Cert. den. 296 U. S. 588; *Pitman* v. *Commissioner* (C. C. A. 10th, 1933), 64 F. 2d. 740.

Other matters which go as well to repeal by implication as to legislative interpretation, now asserted, are dealt with in the text.

that it was not intended to cover all exemptions secured by the Farm Loan and other special exemption acts. The revenue acts are not, as contended by petitioner, *in pari materia* with the Farm Loan Act; the Farm Loan Act is a special act dealing comprehensively with all the relations of the farm loan system to the Government. Section 26 is concerned with all phases of tax exemption in that system. The revenue acts relate to the raising of revenue in general, and make no attempt to encompass special exceptions or exemptions contained in special acts. (See note, p. 48, *supra.*)

The history of the administration of the Farm Loan Act demonstrates that the Treasury Department has always regarded Section 26 alone as the controlling statute. No mention, so far as we have been able to find, has ever been made of the revenue acts as interpreting Section 26 or having anything to do with its exemption. Circulars prepared by the agency charged with the administration of the Farm Loan Act (as authorized and required by Section 3 of the Act) have always referred to Section 26 as the sole applicable exemption statute. Moreover, when in 1923, after eight years of such representation to the public, Congress extended the provisions of Section 26 to Intermediate Credit Banks, it did so in language that gave not the slightest intimation that the section had been in any way interpreted or limited by any other statute whatsoever. Again in 1934, when the Federal Farm Mortgage Corporation was established, there was no intimation that the language of exemption in that statute, which was identical with Section 26, had been in any way limited or interpreted; and again this was true in 1938, when the same language of exemption was used in the Commodity Credit Corporation Act. See these three acts and Appendix, p. .

It is required by Section 21 of the Act that among other things the bonds shall show on their face that they are "not taxable by national, state, municipal or local authority." Pursuant thereto and from the very beginning the bonds

(R. 33) have consistently quoted the language of Section 26 as being the sole measure of exemption, reading:

> "This bond is issued under authority of the Act of Congress approved July 17, 1916, which provides that 'farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they *and the income derived therefrom* shall be exempt from Federal, State, municipal, and local taxation.'" (Italics added.)

If, as petitioner now claims, Section 26 was restricted to "interest" the Revenue Act of 1916, the bonds should have so stated. A determination now that the Revenue Act rather than the Farm Loan Act was the applicable statute would place the government in the embarrasing position of having approved and delivered over a period of twenty years bonds containing a misrepresentation as to the applicable statute.

In our view there was no such misrepresentation. The Government was very careful to publicize the proper exemption statute. For following the amendment of Section 26 by the Revenue Act of 1938, Section 817, joint stock land bank bonds were changed to read as follows:

> "This bond is issued under auhority of the Federal Farm Loan Act, approved July 17, 1916, and amendments thereto. Section 26 of the Federal Farm Loan Act, as amended, provides that 'Farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such, they and the income derived therefrom, shall be exempt from Federal, state, municipal and local taxation. Section 817 of the Revenue Act of 1938, effective May 27, 1938, provides that, notwithstanding the provisions of Section 26 of the Federal Farm Loan Act as amended, in the case of . . . obligations issued by any joint stock land bank after the date of the enactment of this Act, all income, except interest, derived therefrom shall be included in gross

income and shall not be exempt from Federal income taxation.' "[50]

III. Neither the Rule of Strict Construction Nor the Argument Based on the Exemption from State Taxation Can Prevail.

A. The doctrine of strict construction cannot defeat the exemptions contained in the Farm Loan Act. It is really a part of the larger doctrine[51] that acts levying taxes will not be extended by implication beyond the clear import of the language used. That is, a tax act will be construed strictly to exclude subjects from taxation which are not clearly within the language used, and strictly to limit exemptions from the tax where the subject of the tax is clearly within the act. None of the cases cited by petitioner, Brief p. 21, go beyond this point, and none of them justify restricting the plain meaning of the words used in Section 26. Here the Government, in asserting the tax, takes the position that gains and profits are one kind of income within the meaning of the income tax act; but if so, so also is that particular type of gain or profit derived from bonds issued by joint stock land banks, and as such exempt. Construing the word "income" strictly does not keep gains and profits from amounting to "income"; nor by construing strictly the phrase "income derived therefrom" can the source of that income be changed. Just so, construing these words strictly cannot keep the gains and profits here involved from the exemption granted by Congress. As stated by this

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[50] The first issue of bonds under the amendment was subsequent to the date of the trial of this case. However, the court may take judicial notice of the provision of the bonds. *Grosfield* v. *First National Bank*, 73 Mont. 219, 231, 236 Pac. 250, 254; *McNeil* v. *McNeil*, 61 Utah 141, 144, 211 Pac. 988; *cf. Caha* v. *United States*, 152 U. S. 211, 221.

[51] *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 93; *Gould* v. *Gould*, 245 U. S. 151, 153; and see the collection of many cases in 1 Paul and Mertens, Law of Federal Income Taxation, Section 3.31, pp. 62-66.

Court in *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 94:

> "The rule of strict construction is not violated by permitting the words of a statute to have their full meaning, or the more extended of two meanings. The words are not to be bent one way or the other, but to be taken in the sense which will best manifest the legislative intent."

And in *Pittman* v. *Home Owners Loan Corporation*, 308 U. S. 21, 31, the Court said:

> "The critical term in the present relation is 'loans.' We think that this term, in order to carry out the manifest purpose of the broad exemption, should be construed as covering the entire process of lending, the debts which result therefrom and the mortgages given to the corporation as security."

The doctrine of strict construction is only an aid to construction. *Citizens' Bank* v. *Parker*, 192 U. S. 73, 86; *United States* v. *Freeman*, 3 How. 556, 565; *Kohlsaat* v. *Murphy*, 96 U. S. 153, 160. The Court cannot examine one canon to the exclusion of all others; nor is a doubt to be decisive against an exemption until all effort to determine the true intent has failed, for it is the function and duty of the court to resolve doubts. *White* v. *United States*, 305 U. S. 281, 292. The goal is the determination of the intent of Congress, and all aids to finding that intent are to be seized.[52] We believe that a reading of Section 26, either by

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[52] "We recognize the force and salutary character of the rule, but it must not be misunderstood. It is not a substitute for all other rules. It does not mean that whenever a controversy is or can be raised of the meaning of a statute, ambiguity occurs, which immediately and inevitably determines the interpretation of the statute. The decisive simplicity of such effect is very striking. It conveniently removes all difficulties from judgment in many cases of controverted construction of laws. But we cannot concede such effect to the rule, nor is such effect necessary in order to make the rule useful and, at times, decisive. Its proper office is to help solve ambiguities, not to compel an immediate surrender to them—to be

itself or in its setting in the act as a whole, makes the meaning of Congress evident that gains and profits shall be exempt. If that is so, the doctrine of strict construction is wholly inapplicable: the statute must be applied according to its plain meaning. *Pittman* v. *H. O. L. C.*, 308 U. S. 21, 31; *Kohlsaat* v. *Murphy*, 96 U. S. 153, 160; *Citizens' Bank* v. *Parker*, 192 U. S. 73, 86; *United States* v. *Shreveport Gr. & El. Co.*, 287 U. S. 77, 83; *Hamilton* v. *Rathbone*, 175 U. S. 414, 421. Still, if canons of construction are to be called into play, that of strict construction cannot over-balance the legislative history of the act itself, the administrative construction given the act in this connection, nor the legislative construction of the act. Petitioner should not ask the Court to substitute for the policy shown to have been adopted by Congress, the judge-made rule of strict construction.[53] Petitioner would have the Court, under the cloak of strict construction, amend Section 26 retroactively, Congress amended it in 1938[54] only prospectively.

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an element in decision, and effective, maybe, when all other tests of meaning have been employed which experience has afforded, and which it is the duty of the courts to consider when rights are claimed under a statute." *Citizens' Bank* v. *Parker*, 192 U. S. 73, 85-86. *Cf. Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 89.

[53] "That [the judicial] department has no will, in any case. If the sound construction of the act be, that it exempts the trade of the Bank, as being essential to the character of a machine necessary to the fiscal operations of the government, from the control of the States, Courts are as much bound to give it that construction, as if the exemption had been established in express terms. Judicial power, as contradistinguished from the power of the laws, has no existence. Courts are the mere instruments of the law, and can will nothing. When they are said to exercise a discretion, it is a mere legal discretion, a discretion to be exercised in discerning the course prescribed by law; and, when that is discerned, it is the duty of the Court to follow it. Judicial power is never exercised for the purpose of giving effect to the will of the Judge; always for the purpose of giving effect to the will of the Legislature; or in other words, to the will of the law." *Osborn* v. *The Bank*, 9 Wheat. 738, 866.

[54] Revenue Act of 1938, § 817, 12 U. S. C. § 931a, *supra*, p.

Furthermore, the Federal Farm Loan Act, it has been held, carries out a public purpose.[55] Exemptions begotten from motives of public policy are not to be narrowly construed.[56]

B. Petitioner attempts to glean support for its restriction of the language of Section 26 by reason of its provision exempting the bonds and income derived therefrom from state taxation. Petitioner argues (Petr.'s Brf. pp. 12-14) (1) that the exemption from state taxation granted by Section 26 was merely intended to be declaratory of the constitutional immunity that would exist in the absence of a Congressional declaration to the contrary; (2) that under *Wilcutts* v. *Bunn* the states have constitutional power to tax capital gains on the sale of Federal bonds "in the absence of a Congressional declaration to the contrary" (Petr.'s Brf. p. 14); (3) that consequently Section 26 intended to exempt mere interest and not capital gains.

There are a number of answers to this involved argument:

In the first place, petitioner commits the logistic fallacy of *petitio principii*, for this question does not arise "in the absence of a Congressional declaration to the contrary". Rather, Congress expressly exempted the bonds "and the income derived therefrom". The argument therefore does

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[55] *Krauthoff* v. *Kansas City Joint Stock Land Bank* (8th C. C. A. 1929), 31 F. 2d, 75, 78; *Smith* v. *Kansas City Title & Trust Co.*, 255 U. S. 180, 207-209. These purposes are fully set out above, pp. ———.

[56] *Helvering* v. *Bliss*, 293 U. S. 144, 150-151; *Pittman* v. *H. O. L. C.* 308 U. S. 21, 31; *United States* v. *Pleasants*, 305 U. S. 357, 360, affirming 86 C. Cls. 679, 22 F. S. 964, 971; *McFeely* v. *Commr.*, 296 U. S. 102, 111; *Trinidad* v. *Sagrada Orden de Predicadores*, 263 U. S. 578, 581-582; *White* v. *United States* (C. Cls. 1938), 86 C. Cls. 728, 743, 22 F. S. 821, 829; *Federal Land Bank* v. *Crosland*, 261 U. S. 374, 377; *Roche's Beach, Inc.* v. *Commr.* (2d C. C. A. 1938), 96 F. (2d) 776, 779; *Union & New Haven Tr. Co.* v. *Eaton* (D. C. Conn. 1927), 20 F. (2d) 419, 421; *Y. M. C. A. Retirement Fund, Inc.* v. *Commr.* (1929), 18 B. T. A. 139, 146; *Heinz* v. *Commr.* (3d C. C. A. 1939), 101 F. (2d) 453.

not advance us, for the question remains that of whether Congress, by Section 26, intended to exempt capital gains. Secondly, Section 26 was not merely declaratory of the exemption which would have existed without it; Congress did not intend merely to declare what the law would have been as to state taxation if Section 26 had never been written. Rather, while there had been some uncertainty as to how far Congress could go, there is no uncertainty about the fact that it wanted to go the complete limit to protect its new venture from both state and Federal taxation. While true that some opponents of the exemption urged that Congress itself had no power to exempt *any* property from state taxation and that whatever exemption might be granted must stem from the Constitution itself, it was clearly recognized, even by these opponents, that the exemption section *did* assert a power on the part of Congress to exempt property from taxation which would not without it be exempt under the Constitution. It was opposed for that very reason.[57] On the other hand, proponents of the bill urged that Congress had the right in creating an instrumentality to protect it completely from taxation by states, and that unless Congress acted to do so, it left the states free to tax.[58]

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[57] That was a principal ground for Senator Cummins' moving to strike the entire exemption section (Cong. Record, Vol. 53, p. 7245). Among other things, he said: "I do assert, however, with the utmost confidence, that Congress cannot in any form or in any way by declaration remove property from the power of state taxation. It has never been attempted before, I believe. I have never heard it asserted *until I found it in this bill.*"

[58] Senator Hollis, in charge of the bill in the Senate, cited and quoted from *Van Allen* v. *The Assessors*, 3 Wall. 573, 582, to support this contention, and then said (Cong. Record, Vol. 53, p. 7313):

> "When the Government occupies a field which the Constitution permits it to occupy, it may occupy it exclusive of state occupation, or may occupy it with such conditions as it chooses through its Congress to impose. That is what was decided in the case of Van Allen * * * Therefore, if we have a right to establish this instrumentality to help out a proper govern-

The dispute in Congress as to the power of the Federal Government to exempt the bonds and their income from state taxation was settled by this Court in *Smith* v. *Kansas City Title & Trust Co., supra.* In that case Section 26 was considered "the real issue sought to be settled here." (p. 211.) It was said "to be an invasion of state authority to extend the tax exemption so as to restrain the power of the state." (p. 212.) But this Court then squarely held (p. 211):

> "Deciding as we do that these institutions have been created by Congress within the exercise of its legitimate authority, we think the power to make the securities here involved tax exempt necessarily follows. This principle was settled in *McCulloch* v. *Maryland* and *Osborn* v. *Bank, supra.*
>
> "That the Federal Government can, if it sees fit to do so, exempt such securities from taxation, seems obvious upon the clearest principles . . .
>
> "The same principle has been recognized in the National Bank Cases, declaring the power of the states to tax the property and franchises of national banks *only to the extent authorized by the laws of Congress. Owensboro Natl. Bank* v. *Owensboro,* 173 U. S. 664, involved the validity of a franchise tax in Kentucky on national banks. In that case this court declared (pp. 668, 669) that the states were wholly without power to levy any tax directly or indirectly upon national banks, their property, assets or franchises, *except so far as the permissive legislation of Congress allowed such taxation; . . .*" (Italics added)

In the third place, the basis for petitioner's assumption that since under *Willcuts* v. *Bunn* capital gains on state bonds are not exempt from Federal taxation, capital gains on Federal bonds are not exempt from State taxation, is not

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mental function, then we have a right to annex to it such conditions of taxation in favor of states or such exemption from taxation in favor of the instrumentality as Congress, in its discretion, as a matter of policy sees fit to impose. There cannot be any escape from that."

entirely clear.[59] As this Court has recently pointed out, the two types of immunity do not in all respects stand on parity. *Graves* v. *People of New York,* 306 U. S. 466, 478; *Helvering* v. *Gerhardt,* 304 U. S. 405. This fact was recognized as early as *McCulloch* v. *Maryland,* 4 Wheat. 316, and strongly reiterated in the very case upholding the constitutionality of the very section herein involved. *Smith* v. *Kansas City Title & Trust Co.,* 255 U. S. 180; see also *Federal Land Bank* v. *Crosland,* 261 U. S. 374.

It must not be forgotten that in the *Bunn* case the Court clearly indicated that had there been convincing evidence of an appreciable burden on the bonds from the tax, the result would have been different (p. 230). As to such burden, however, no evidence whatever was introduced; the Court was "left to the inadequate guidance of judicial notice" (p. 230). The Court's decision must be viewed in the light of this absence of convincing evidence, consideration of which was made necessary because of the absence also of any legislative expression indicating belief in the existence of such burden. Had there been such an expression it is respectfully submitted that (subject to the foregoing principle that state and Federal powers and immunities are not entirely reciprocal) the result would have been different. There is such an expression here.

At any rate, petitioner's argument shows the fallacy of trying to ascertain Congressional intent by delving into constitutional conjectures.

C. We have not overlooked the number of cases cited by petitioner (Brief, pp. 14-16), to support its contention that "broad statutory exemptions" are "inapplicable

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[59] Petitioner's entire argument on this point simply reiterates in a slightly different form an argument first set forth by the author of the majority opinion in the related case, *Agricultural Securities Corp.* v. *Commissioner,* 39 B. T. A. 1103, 1109. There it was frankly predicated upon the exploded doctrine that similar principles govern state and Federal enjoyment of such immunities; and since capital gains from state bonds were not free from Federal tax, under *Willcuts* v. *Bunn,* therefore Congress did not intend to free capital gains on these farm loan bonds from its own tax.

where the subject matter of the exemption is involved only indirectly." We have here no such situation. As the court below stated (R. 134-5), the cases cited are readily distinguishable. In not one of them was there an exemption aimed squarely at and designed to defeat the very tax asserted, as here. Thus, in some instances, the tax was not upon property or income but upon the *transfer* by death or gift, whereas the exemption ran to the "bonds and the income derived therefrom" (*Igleheart* v. *Commr.*, 77 F. 2d 704, C. C. A. 5th), or the "principal and interest" (*Plummer* v. *Coler*, 178 U. S. 115; *Murdock* v. *Ward*, 178 U. S. 139; *Greiner* v. *Lewellyn*, 258 U. S. 384; *Hamersley* v. *United States*, 16 F. S. 768, C. Cls.; *Phipps* v. *Commr.*, 91 F. 2d 627, C. C. A. 10th, cert. den. 302 U. S. 742); in some the tax was on interest, whereas the exemption was restricted to direct property taxes (*Hale* v. *State Board*, 302 U. S. 95); in some the tax was an income tax on capital gains, whereas the exemption was only to "principal and interest" (*Central Hanover Bank & Trust Co.* v. *United States*, 14 F. S. 541, C. Cls., cert. den. 300 U. S. 678; *DeStuers* v. *Commr.*, 26 B. T. A. 201; *Roebling* v. *Commr.*, 37 B. T. A. 82); some involved tax upon income in the form of salary or dividends, whereas the exemption ran only to "principal and interest" of bonds (*Hitner* v. *Lederer*, 63 F. 2d 877, C. C. A. 3rd; *James* v. *Commr.*, 13 B. T. A. 764, 49 F. 2d 707, C. C. A. 2nd; *McGuire* v. *Commr.*, 32 B. T. A. 1075); one of them was a tax upon transfer by death, whereas the exemption was on the proceeds of an insurance policy of veterans insurance (*U. S. Trust Co.* v. *Helvering*, 307 U. S. 57); one of them, *Wilson* v. *Commr.*, 31 B. T. A. 1022, is not even remotely in point.

The present tax is levied by its plain words directly upon income (Revenue Act 1928, §11). The applicable exemption is of "income" which is derived from Federal farm loan bonds, and the words which convey it were, as already shown, chosen with a special view to exemption from this particular tax. See *supra*, pp. 23-24. Furthermore, the ex-

emption has been specifically construed already to prevent indirect taxation of its subject matter. *Federal Land Bank* v. *Crosland*, 261 U. S. 374; *West Co.* v. *Johnson*, 66 P. 2d, 1211, cert. den. 302 U. S. 638, rehearing denied, 303 U. S. 666; *cf. Pittman* v. *H. O. L. C.*, 308 U. S. 21.

IV. Petitioner is Estopped to Assert the Tax.

Even if Section 26 were susceptible of the construction contended for by petitioner, petitioner is nevertheless estopped to collect a tax in this case. As the courts below found (R. 42-43), respondent relied upon representations of a United States agency (the Farm Loan Board, a division of the Treasury Department) in making his purchases of bonds, "reasonably believing he was purchasing securities the income from which, in case of sale, would be exempt income." No interest was being paid by the banks whose bonds he purchased; he purchased them only for their prospective increment. (R. 41-42.)

The representations upon which respondent relied were authorized by the statute. Section 3 of the Federal Farm Loan Act (Appendix, p. 2) specifically makes it "the duty of the Federal Farm Loan Board * * * to prepare and distribute * * * circulars * * * advising investors of the merits and advantages of farm loan bonds." Although petitioner takes the position (note 14, Petr.'s Brf. p. 20) that this does not authorize representations that capital gains are exempt, nevertheless the exemption of capital gains is one of the "merits and advantages" of these bonds; and as the concurrent findings below show, it was the particular merit and advantage of the bonds in which respondent was concerned and upon which he relied.[60]

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[60] We concede there would be no estoppel of the United States if its agents had no authority to make the representations they did. See *State of Utah* v. *United States*, 284 U. S. 534, 546; *Utah P. & L. Co.* v. *United States*, 243 U. S. 389, *et seq.*; *Wilber Nat. Bank* v. *United States*, 294 U. S. 120, 123. Here, as is pointed out in the text, there is express authority by statute for the representation.

Petitioner takes the position that whether such gain is exempt is a question of law rather than a question of fact; and reliance upon a representation of law is at the taxpayer's peril.[61] This should make no difference in a case of this kind. The proposition is discussed in *Staten Island, etc., Co.* v. *United States* (C. C. A. 2d, 1936), 85 Fed. (2) 68, 71. It was there held:

> "Between private parties it seems to be well established that equitable relief may be had where a mistake as to the plaintiff's legal rights is induced by misrepresentations, even though innocently made, if it is reasonable for the plaintiff to rely upon the presumably greater knowledge of the defendant. [Citing cases] It should make no difference that the United States is the party against whom rescission is sought."

Thus also in *Black* v. *Bolen* (1920, W. D. Okla.), 268 Fed. 427, writ of error dismissed *per cur.* (C. C. A. 8, 1921), 277 Fed. 1013, the Commissioner had advised the taxpayer that, a claim for abatement having been filed, it was unnecessary to file a claim for refund before instituting suit. This was purely a matter of law. When the taxpayer brought an action for refund, the Collector was held estopped to assert the necessity of previously filing a claim. See also *Glynn* v. *United States* (1897), 32 C. Cls. 100, 101. *Cf.*

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[61] The cases relied upon in this connection are beside the mark. In *Sturm* v. *Boker*, 150 U. S. 312, 335, there was, as stated by the Court, only an expression of opinion on a matter of law, which did not mislead or induce defendants to change their position; in *Mutual Life Ins. Co.* v. *Phinney*, 178 U. S. 327, the question of estoppel was passed over because the Government otherwise had established no case; there were no "representations" in the sense in which that term is here used; the taxpayer had not, as here, changed its position in reliance on authorized representations by the Government's agent. *Helvering* v. *Gerhardt*, 304 U. S. 405, does not deal with estoppel but is possibly cited for the proposition that if a regulation holding income of a particular kind immune from tax is not authorized by the statute which does undertake to tax such income, the regulation must fall before the statute. p. 423. But this does not help in determining whether the representations herein involved were authorized by the statute.

Denver & R. G. R. Co. v. *United States* (1918), 53 C. Cls. 155, 166.

Many cases have held the United States to be estopped on facts no more compelling than those in the instant case. *Knight, Adm'r* v. *United States* (1900), 35 C. Cls. 129, 145; *Duval, Rec'r* v. *United States* (1889), 25 C. Cls. 46, 60; *Hartson* v. *United States*, 21 C. Cls. 451, 456; *United States* v. *Great No. Ry. Co.* (8th C. C. A., 1932), 57 F. (2d) 385, 393, aff'd 287 U. S. 144; *Branson* v. *Wirth*, 17 Wall. 32, 42; *William C. Atwater & Co.* v. *United States* (S. D. N. Y., 1936), 18 F. Supp. 564; *United States* v. *Bank of Metropolis*, 15 Pet. 377, 392; *Joseph Eichelberger & Co.* v. *Comm'r Int. Rev.* (5th C. C. A. 1937), 88 F. (2d) 874; *Cooke* v. *United States*, 91 U. S. 389, 398; *Eager* v. *United States* (1898), 33 C. Cls. 336, 338. *Cf. Ritter* v. *United States* (3d C. C. A., 1928), 28 F. (2d) 265, 267; *Woodworth* v. *Kales* (6th C. C. A., 1928), 26 F. (2d) 178, 180; *Lindsey* v. *Hawes*, 2 Black 554, 560.

V. CONCLUSION.

The decision of the court below should be affirmed.

Respectfully submitted,

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